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(Continued inside cover)

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CONTENTS

(*Continued from front cover*)

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National Tax Journal

Volume I, No. 1 March 1948

WAR AND POSTWAR DEVELOPMENTS IN THE GERMAN TAX SYSTEM

MABEL NEWCOMER *

TAX yields in Germany in 1946-47 were for the most part sufficient to balance budgets. In view of the disorganized state of the German economy, and the turnover in government personnel, this financial achievement came as a surprise even to those who set balanced budgets as their goal. It is true that many normal government activities have not yet been resumed at former levels, and that Germany is spared the cost of a military establishment. On the other hand occupation costs are heavy, and most of these do not contribute directly to the welfare of the German population. Direct occupation costs and occupation-induced costs, such as support of displaced persons, refugees, and expellees, amounted to two-fifths of the expenditures of Land governments in the United States Zone in 1946-47. It is estimated that for Germany as a whole the proportion is higher—perhaps 50 per cent. Even when local government expenditures are included in the total it seems probable that at least 40 per cent of government costs were occupation and occupation-induced costs in this year.[1]

Another factor that suggests that the German tax burden is unusually heavy is the extremely low living standards now prevailing. Real income is estimated to be approximately 40 per cent of its 1939 level.[2] In spite of this low

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[1] Figures for revenues and expenditures of the U. S. Zone are from the Office of Military Government for Germany (U. S.), *Report of the Military Governor*, 1 July 1946—30 June 1947, no. 24. Data for other zones are incomplete and from a variety of sources, but these proportions are believed to be approximately correct.

[2] Deutsches Institut für Wirtschaftsforschung, *Die Deutsche Wirtschaft Zwei Jahre Nach dem Zusammenbruch*, p. 269. The division of Germany into zones, as well as the breakdown of former statistical services, make exact estimates impossible. This source is believed to be the most reliable available. The Institut has a staff of able economists and its location in Berlin gives it a material advantage over organizations elsewhere in obtaining information.

level of production, tax collections amounted to about 36 per cent of the gross national product. In the United Kingdom, where per capita real income was at approximately its prewar level in 1946, and clearly higher than real income in Germany, taxes amounted to 32 per cent of the gross national product. And in the United States, with still higher standards of living, taxes—Federal, state, and local—amounted to 28 per cent of the gross national product in this same year.[3]

The level of German taxes today is the result of Allied Control Authority legislation. But the basic tax law has not been greatly changed. Consequently, it is necessary to outline some of the war and prewar developments in German taxes in order to evaluate the present system.

Development of the German Tax System Under the Nazi Government

Two important changes were made by the Nazi government in the German tax system. The first was to accelerate the process of centralization of taxes. The second was to introduce many tax concessions for favored groups, accompanied by special taxes on persecuted groups.

Centralization of the tax system started long before the Nazi regime, as the inevitable consequence of increasing centralization of government functions. Policies under the Nazi government introduced no sharp break with earlier developments.

The only important taxes levied by the German central government in its early history were customs duties and a few excises. The revenues from these sources were supplemented by requisitions on the Laender. With the development of a costly armaments program these revenues proved inadequate and were supplemented by new imperial taxes. Thus the tendency for the central government to take over tax sources, at the expense of the Laender, was apparent even before World War I.

The cost of World War I proved a heavy drain on the depleted resources of the country, and the resulting financial crisis led to the adoption of a highly centralized tax system under the Weimar Constitution. Personal and corporation income taxes, the turnover tax, and taxes on tobacco and beer became important Reich taxes, together with many lesser sources of revenue.

The only important taxes remaining to Laender and local governments as independent sources were the local trade and real estate taxes and a new tax on rentals, which was introduced as a temporary measure to equalize losses from inflation.

Land and local governments were recompensed for losses from former tax sources taken over by the Reich with a generous share of the proceeds of these centrally administered taxes. But as Reich needs grew the local share was reduced, and with World War II the Reich took over most of the remaining taxes. By 1943 the Laender were left with no independent taxes of any importance, and the communes had only the real estate tax and a few minor levies, such as the entertainment and dog taxes.

These changes were not entirely a

[3] Data for the United Kingdom from *National Income and Expenditure of the United Kingdom, 1936 to 1946, Cmd. 7099, 1947.* Data for the United States from *National Income Supplement to the Survey of Current Business*, July, 1947.

reflection of the tendency in Germany and elsewhere to centralize government functions. They were also a part of deliberate Nazi policy to weaken the Laender. The communes continued to exercise a small measure of financial independence. The extent of this centralization is shown in Table 1.

TABLE 1

TAX REVENUES COLLECTED AND SPENT BY REICH AND LOCAL GOVERNMENTS FOR SELECTED YEARS[a]

Fiscal Year	Collections			Allocations		
	Total	Reich	Land and Local	Total	Reich	Land and Local
			Million Marks			
1913-14	4,046	1,631	2,415	4,046	1,631	2,415
1928-29	13,339	9,023	4,316	13,339	5,610	7,729
1937-38	18,681	14,672	4,009	18,681	11,870	6,811
1943-44	40,000	38,000	2,000	40,000	30,600	9,400
			Percentage Distribution			
1913-14	100	40.3	59.7	100	40.3	59.7
1928-29	100	67.6	32.4	100	42.1	57.9
1937-38	100	78.5	21.5	100	63.5	36.5
1943-44	100	95.0	5.0	100	76.5	25.4

[a] Data from *Statistisches Jahrbuch,* except for 1943-44. 1943-44 Reich taxes from *Die Deutsche Wirtschaft, op. cit.,* p. 199. Local taxes estimated.

Comparative War Tax Levies: Germany, Great Britain, and the United States

Total taxes for all levels of government increased from 22.9 billion RM to 49.1 billion RM between 1938 and 1942, the peak year of tax collections. This peak was reached only because the rentals tax (Gebäudeentschuldungssteuer) was terminated in this year with a levy of ten times the annual tax. Without this special levy, collections would have been 41.1 billions, less than double the prewar yield. Part of the increase in Reich taxes came from taking over former local levies, notably the citizen tax (Buergersteuer), which was merged with the income tax in 1942, and the trade tax and rentals tax, taken over in 1943. Without these, Reich collections would at no time have been double the prewar peak. Annual collections are given in Table 2.

Germany had one advantage not shared by the Allies during this period, namely, substantial revenues from occupied territories. Most of the gain came from direct support of the army, but goods and workers were also shipped into Germany, and for Poland and Czechoslovakia cash contributions were made to the German budget. The actual cash contributions were small, but the direct support of the army was an important item in some years. Exact figures are not available, but estimates from incomplete data indicate that they amounted to between one-fifth and one-fourth of all net revenues. Even with this aid only 44 per cent of Reich expenditures were covered in 1943-44. Taxes alone amounted to only 25 per cent of the total costs.

In the six years 1939 to 1945 Reich tax collections amounted to 26 per cent

of Reich expenditures. In the same period British national tax collections equalled 61 per cent of national expenditures.[4] For the United States in the four years of the war period, 1941-42 to 1944-45, taxes covered 40 per cent of expenditures. In the last year of the war, tax collections rose to 65 per cent of expenditures in Great Britain, and 43 per cent in the United States. In Germany, on the contrary, they fell to 16 per cent in this year.

TABLE 2

REICH, LAND, AND LOCAL TAX RECEIPTS, 1938/9 TO 1946/7
(Billion RM)

Year	Reich Taxes[a]		Land[b]	Local[b]	Total
	Regular	Special			
1938/9	17.7	..	0.8	4.4	22.9
1939/40	23.6	..	.7	4.8	29.1
1940/1	27.2	..	.8	5.2	33.2
1941/2	32.3	..	.8	5.7	38.8
1942/3	34.7	8.0	.6	5.8[c]	49.1
1943/4	37.9	.1	..	2.0[d]	40.0
1944/5[e]	27.7	..	..	2.0	29.7
1945/6[f]	10.0	..	..	2.7	12.7
1946/7[f]	21.0	..	..	3.0	24.0

[a] U. S. Military Government, Economics Division, *Statistical Handbook of Germany,* through 1943/44. 1944/45 to present estimated on basis of incomplete data.

[b] Hansestaedte included in local. Data from Kehl, in *Karteiblatt der Statistischen Praxis,* July, 1947, through 1943/44, except for changes explained in notes *c* and *d* below.

[c] Reduced by .4 billion RM because of discontinuance of citizen tax (Buergersteuer).

[d] Reduced by .7 billion RM because of discontinuance of citizen tax (Buergersteuer), and 3.6 billion RM because of transfer of trade tax (Gewerbesteuer) to Reich.

[e] Estimated on basis of incomplete data. Budget figures were much higher.

[f] Complete data available only for U. S. and British Zones. Figures for other zones estimated.

These figures indicate that Germany did not make the same effort to cover costs from taxes that other countries made during the war. This conclusion is further substantiated by comparisons of tax increases in these countries. In 1943-44 Reich tax collections were a little more than double collections in 1939-40. British taxes more than tripled in this period and the United States Federal taxes increased more than sevenfold.

In making these comparisons it must, of course, be kept in mind that the German tax level was comparatively high in the prewar period. Taking the overall tax figures for the war period, for all levels of government, they amounted to 30 per cent of the total national product in the United Kingdom, 21 per cent in Germany, and 20 per cent in the United States.[5] This suggests that Germany fell short of the United Kingdom in tax effort, but not of the United States.

Comparing individual tax rates, the German personal income tax rate reached a maximum of 67 per cent, as compared with 94 per cent in the United States, and 97.5 per cent in the United Kingdom. The personal exemption, on the other hand, was lower. The inheritance tax reached a maximum rate of only 60 per cent, as compared with 85 per cent in the United Kingdom, and 77 per cent (not including state levies) in the United States.

The normal tax on corporations was 55 per cent in both Germany and the

[4] This percentage would be somewhat smaller—53 per cent—if Lend-Lease, which assisted the British in somewhat the same way as levies on occupied nations assisted the Germans, were to be included in British expenditures. This, however, has been included in the United States expenditures.

[5] Data for the United Kingdom from *Cmd. 7099, op. cit.;* for the United States from *National Income Supplement, op. cit.;* for Germany from *Die Deutsche Wirtschaft, op. cit.*

United Kingdom (for the United Kingdom this includes the " National Defense Contribution " but not the excess profits duty). It was 40 per cent in the United States. Excess profits taxes in Germany reached 85 per cent (55 per cent normal plus 30 per cent excess profits tax) compared with 95 per cent in the United States and 100 per cent in Great Britain.[5a]

The German tax on cigarettes amounted to about two-thirds of the retail price. That in the United States amounted to from one-half to two-thirds, depending on price and the state tax. The British tax was 85 per cent. The German tax on spirits amounted to 25 to 30 per cent of the retail price of whisky; the United States tax amounted to 60 to 65 per cent, exclusive of state taxes; and the British tax to approximately 75 per cent. The German turnover tax was heavier than the comparable British and United States taxes on necessities. The rates were comparatively low and there were reductions for food; but food was not exempted and the tax was applied on each turnover. At the other end of the scale, there were none of the luxury taxes imposed in the United States and Great Britain. The United States had many 20 per cent levies and the British purchase tax was 16⅔ per cent on non-essentials and 100 per cent on luxuries.

The differences in the structure of the various taxes makes exact comparisons impossible, but the taxes on the lower income groups—taking into account the lower income-tax exemption and the heavier taxes on food—appear to have been somewhat higher in Germany than in Great Britain and were certainly substantially higher than in the United States. Taxes on the higher income groups, on the contrary—judging by the maximum tax rates on income and inheritance and the luxury levies—appear to have been appreciably lower in Germany than in either Great Britain or the United States. Since these are the groups best able to pay, it is apparent that German taxes did not tap existing wealth to the same degree that the British taxes did. It is important to keep this in mind when evaluating the heavy increases of the postwar period.

The Tax System Under the Occupying Powers

The German tax administration continued to function through the last months of the war and the early months of the occupation, although collections dropped sharply as a result of the disruption of industry and substantial tax delinquencies.

The Potsdam Agreement laid the basis for uniform taxes. Paragraph 14 of this agreement states that " during the period of occupation Germany shall be treated as a single economic unit. To this end common policies shall be established in regard to . . . central taxation and customs." The Potsdam Agreement also required the abolition of discriminatory legislation.

In the absence of a central German government, uniform taxes became the obligation of the Allied Control Authority. Existing tax laws were continued in force, except for the discriminatory features. Administration

[5a] No provision was made for a postwar refund for the German tax; however, such refunds were provided for the United States tax (10 per cent of the tax) and the British tax (20 per cent).

was entrusted to Land governments, which also retained the revenues for their own use, and to meet occupation costs. However, the existing level of taxes appeared inadequate to balance Land budgets, and it was agreed that taxes should be revised upward. A quadripartite taxation committee was established for this purpose in the Fall of 1945, and as a result of the work of this committee revisions were made in all of the major taxes in the next few months.

The first of these laws specifically abolished the discriminatory provisions in all tax laws. Other provisions of this law do away with the special exemptions, for purposes of income taxation, for large families and for holding companies. The latter measure is in support of decartelization policy. Most of the changes introduced by this series of laws consisted, however, of upward revisions of the tax rates. The basic structure of existing German taxes was, for the most part, unchanged. The rate increases are shown in Table 3. No new taxes were introduced.

Revenues under the new legislation, compared with those in the year preceding, are given in Table 4. The extent to which yields were increased by legislation and the extent to which they were increased by growing economic activity cannot be accurately estimated, but the latter factor is important, as indicated by the increased yields of taxes not affected by Control Council legislation.

Evaluation of Postwar Tax System

Many problems of interpretation have arisen under these new laws. The committee responsible for the revisions did its work in a very limited period of time; and it did not have any complete codification of existing German tax law available. The exact legal status of the numerous Reich decrees was uncertain, even when the existence of the decrees was known. In particular, the occupying powers disagreed concerning the validity of decrees established for the "duration of the war." Also, in day-to-day administration different interpretations of the tax law appeared in the different zones. Some of these were

TABLE 3

Allied Control Authority Tax Laws

No.	Tax	Date Passed	Date Effective	Percentage Increase in Rates
12	Wage	11 Feb. 1946	1 Jan. 1946	25% and up
12	Assessed income	11 Feb. 1946	1 Jan. 1946	35% and up
12	Corporation	11 Feb. 1946	1 Jan. 1946	20%
13	Property	11 Feb. 1946	1 Jan. 1946	100-400%
14	Motor vehicle	11 Feb. 1946	1 Jan. 1946	50%
15	Turnover	11 Feb. 1946	1 Jan. 1946	50%
17	Inheritance	28 Feb. 1946	1 Jan. 1946	0-600% not including reduced exemptions
26	Tobacco	10 May 1946	17 May 1946	230% cigarettes, cigars more
27	Alcohol	10 May 1946	17 May 1946	2.314%
27	Vinegar	10 May 1946	17 May 1946	370%
28	Beer	10 May 1946	17 May 1946	40%
28	Matches	10 May 1946	17 May 1946	900%
30	Sugar	20 June 1946	24 June 1946	89%

important. For example, the minimum deduction permitted for expenses under the wage tax in the British Zone was double that permitted in the other three zones. This became a serious problem in Bremen, where workers from the British Zone and workers from the American Zone are often employed in the same factories. Also in the British Zone, deductions for property taxes were allowed for purposes of income taxation that were not allowed elsewhere. On the other hand, the double taxation of holding companies intended under the new taxes was carried through only in part in the United States Zone. Finally, no provision was made in the new legislation for the allocation of taxes derived from income or business extending over more than one zone, and it was impractical to follow former German provisions which assumed a completely centralized system. The formulae adopted, in practice, to meet this difficulty were different in each of the four zones.

These are, however, temporary difficulties that can be ironed out in time, even with the cumbersome quadripartite machinery. The unification of the western zones should facilitate this process, at least in Western Germany. And if there is any failure to come to agreement with the Russian authorities concerning taxes in the Russian Zone, the limited amount of business that crosses zonal borders will minimize the difficulty of different taxes. The Allied Control Authority legislation should be judged, then, not in the light of these temporary difficulties, but in the light of adequacy of revenues, equity, possible interference with German industrial recovery, acceptance by the German people, and consistency with the specific aims of the occupying powers.

Concerning the first of these tests, adequacy, it has already been pointed

TABLE 4

INCREASES IN TAXES RESULTING FROM ALLIED CONTROL AUTHORITY TAX LAWS, U. S. ZONE[a]

No.	Tax	Yield Million RM 1945/46 (old law)	Yield Million RM 1946/47 (new law)	Percentage Increase in Yield
12	Wage	352	680	93
12	Assessed income	577	1,134	97
12	Corporation (not including excess profits)	140	299	114
13	Property	78	360	462
14	Motor vehicle	16	115	619
15	Turnover	287	654	128
17	Inheritance	12	46	283
26	Tobacco	93	629	576
27	Alcohol, Vinegar	18	38	106
28	Beer	112	290	159
28	Matches	4	14	250
30	Sugar	9	27	200
Total:				
	Taxes increased by Control Council laws	1,698	4,286	152
	Taxes not increased by Control Council laws	203	402	98
TOTAL		1,901	4,688	146

[a] *Report of Military Government*, "Statistical Annex," 1-30 June 1947, No. 24, pp. 70-71.

out that German budgets have for the most part balanced. Results in the United States Zone are shown in Table 5. Actual revenues exceeded budget estimates by 12 per cent. Other zones appear to have done almost as well, even though in some other zones occupation costs are a higher proportion of total costs than in the United States Zone.

TABLE 5

Revenues and Expenditures of Four Laender of U. S. Zone,[a] 1946/47

	Million RM	Percentage of Total Expenditure
Tax revenue	4.69	102.6
Other revenue	1.23	26.9
Total revenue	5.92	129.5
Extraordinary costs[b]	2.00	43.8
Ordinary costs	2.57	56.2
Total expenditure ..	4.57	100.0
Surplus	1.35	29.5

[a] Data from *Report of Military Government:* "Finance" 1 July 1946—30, June, 1947, No. 24, p. 15.

[b] Occupation and occupation-induced costs.

Part of this success can be attributed to the fact that some government activities were not fully re-established; part can be attributed to the fact that incomes, however small, were more than adequate for the limited supplies of goods and services available to the German consumer. Also, there were undoubtedly surpluses left over from the more prosperous war period. Whatever the cause, it is a notable achievement. Germany faces a serious problem of inflation, but contrary to the experience following World War I, unbalanced budgets are not contributing to the problem.

Turning to the question of the equitable distribution of the tax burden, we find that progressive direct taxes have not been increased as much as excises. In consequence, the proportion of revenues derived from these direct taxes fell from 56 per cent in 1945-46 to 51 per cent in 1946-47. In view of the fact that the earlier German tax system apparently bore more heavily on the low-income groups as compared with the high-income groups than the British tax system, this increased emphasis on excise taxes can well be questioned. The extreme increases have not affected the average worker's budget greatly, as shown in Table 6. However, when goods become more plentiful and rationing is relaxed or abandoned altogether, these taxes will be an impor-

TABLE 6

Monthly Taxes Paid by Worker with 200 RM Monthly Wage[a]

(in RM)

Tax	Single		Family of Four	
	German Law	C. C. Law	German Law	C. C. Law
Wage	17.68	22.82	3.90	5.18
Tobacco	.50	1.61	.73	2.42
Beer	2.00	2.80	2.00	2.80
Vinegar	0.05	.24	.15	.71
Sugar	.055	.10	.33	.51
Matches	.005	.05	.02	.20
Total	20.29	27.62	7.13	11.82
Percentage of worker's income	10	14	3.5	6

[a] Estimates based on representative family budgets prepared by a quadripartite committee of the Allied Control Authority.

tant factor in the worker's family expenditures.

Considering the third test, possible interference with German industrial recovery, it is apparent that taxes that are so high that they prevent industrial expansion can be just as inflationary in their effect as taxes that are so inadequate that they leave large deficits in government budgets. There have been many complaints concerning the burden of Control Council laws, and frequent assertions that administration is breaking down and industrial activity being checked by excessive levies.

The present tax load is indeed heavy. But the large yield itself belies the assertion that administration is breaking down. Tax evasion there is; but except for black market activities, which necessarily escape taxation, but which are designed to evade price controls rather than taxes, there is little evidence of unusual evasion.

Also, there is no evidence that taxes are an important factor in retarding business recovery. There undoubtedly are cases where the tax burden has operated as a deterrent, but repeated efforts on the part of the Public Finance Branch of our Military Government to get specific cases of this were unsucessful. Answers to inquiries and German newspaper comments indicate that the more important factors checking business have been lack of critical materials and skilled labor, the breakdown of transportation and normal channels of communication, interzonal barriers, the fear of seizure by occupying powers of business properties and products, and the threat of currency reform.

After currency reform has been effected, however, there may well be need for thoroughgoing revision of the tax system. Whether this should take the form of general reductions in rates or more limited special reductions designed to act as a special stimulus for desired developments is debatable. The disadvantages of special reductions are, of course, that they tend to build up favored classes without adequate reason, and that they open the way to unintended tax avoidance or evasions. In favor of such a system is the fact that with the extreme poverty in Germany today general tax reduction may prove a luxury that can hardly be afforded.

If the tax system instituted by the occupying powers is to continue to be effective, as more and more power is turned over to the German people, it must be acceptable to them. The fact that the changes made by the occupying powers have been in rates rather than in the basic structure of the law is in its favor. Changes in taxes, other than reductions in rates, always bring substantial resistance. In this respect the tax revisions are sound. A careful study of the changes indicates that very few were made without any apparently good reason.

As noted above, some changes were made for other reasons than increased revenue. The most important of these was the removal of Nazi "discrimination." This has been accepted by the German governments, but the underlying principle is not completely accepted. There are frequent efforts to set up new privileged groups—the former persecutees, those suffering war losses, or present government officials. The latter group apparently has obtained some special tax concessions in

the Russian Zone. The United States authorities have stood firmly against such new tax inequalities, but they have not succeeded in convincing all the German officials working with them of the merits of this democratic practice.

With regard to decartelization policies, the revised tax law was intended to submit holding companies to complete double taxation of income. Unfortunately, the new law did not clearly accomplish this, and in the American Zone, holding companies are not subject to double taxation on all their income. Also, in the United States Zone, there was some question at first about the tax status of I. G. Farben itself, while under American control. These are transition problems, however. There is nothing in the basic tax law that gives special tax favors to large industrial combinations.

Decentralization is another matter. A decentralized government and a unified national economy in Germany are both important aims of the occupying powers. These are, however, conflicting objectives and compromises will be required to attain some measure of each.

At present there is no central government and there are no central taxes. The first step in decentralizing the German tax system was taken when the former Reich taxes, producing about nine-tenths of the revenues, were given to the Laender. It is significant, however, that while the tax revenues and tax administration were transferred to the Laender, the power of determining the nature of taxes levied was not. Except for limited discretion in local taxes this was reserved for the Allied Control Authority in order to insure the uniformity in taxes that is required for a unified economy.

Moreover, little effort has been made to decentralize below the Land level. Local jurisdictions in some Laender have no more financial independence than they had at the end of the war. In the British Zone there has been even less decentralization than in the American Zone, since many of the important taxes have been pooled for the entire zone and the proceeds, insofar as they exceed needs for occupation costs, redistributed according to a formula.

If strong Land and local governments are desired to prevent the centralization of power in a future central German government, important tax powers must be vested in these authorities. Thus far nothing has been done to accomplish this. Turning over Reich taxes to the Laender was little more than a gesture.

Unsettled Tax Problems of Future Germany

For the immediate future, it is assumed that financial reform will bring changes in the tax system. A capital levy has often been proposed. The purpose of such a levy would be primarily to equalize war and postwar losses, and the proceeds would presumably be redistributed among the losers. Thus far, nothing has been done to assist this group. In view of the heavy losses there is every reason to believe that a capital levy would not yield large revenues, and would, at best, offer only partial compensation for losses. In any case, it will not contribute to ordinary government budgets.

Another change that may, and probably should, be made with financial reform is some reductions in rates, whether specifically designed as special tax incentives or as general relief. In either case it would be necessary to proceed with caution. Temporarily unbalanced budgets might offer some stimulus to industrial activity if there were any important unused resources available. But with the present shortages there is some danger that such reductions would encourage a new inflation rather than increased industrial activity. For that reason reductions should probably be given only where there is some specific evidence that business expansion might result.

For the long run, the most important problem is probably the distribution of tax powers among the different levels of government. This must await the setting up of a central government and the distribution of all government functions. It has sometimes been suggested that a new central government could best be kept under control if its tax powers were sharply limited and it was forced to resort to requisitions on the underlying Laender for support. The history of other federal states does not, however, give any reason to believe that such a financial structure would be successful.[6]

The real problem is to build a democratic central government, not a weak one. Actually, the English and French governments were more highly centralized than the German in the 1920's, if centralization of finances is used as the test. Yet it was Germany that accepted a dictatorship. As pointed out earlier, economic unification and political decentralization are not compatible aims; but economic unification and responsible and democratic central governments are at once possible and consistent with our objectives.

[6] Since the above was written, the information has been received that all excises, transportation taxes, and a share in income and corporation taxes have been assigned to the new central bizonal government.

INCIDENCE OF THE CORPORATION INCOME TAX: CAPITAL STRUCTURE AND TURNOVER RATES

CARL SHOUP *

THE proposition advanced here is that the shifting of a corporation income tax of the kind that is levied by the Federal Government depends largely upon (1) the rate of the tax, (2) the capital structure of the corporation, and (3) the nature of the industry with respect to the normal speed of turnover of assets. Depending on the answers that are given to these questions in any particular case, it seems likely that such a corporation tax will have no effect, a decided effect, or an uncertain effect on the prices charged by the corporation for its products. Reference here is to immediate effect on price policy by the conscious action of the management, induced by the tax. The discussion does not refer to a hypothetical profits tax of a type that strikes only some form of economic rent and hence does not touch real costs. Only forward shifting is covered in the present analysis; this is not intended to imply that backward shifting is not possible.

Rate of Tax

There is substantial disagreement or doubt as to whether a change in rate of " the " corporation income tax may be expected to have an immediate effect on price policy.[1] The doubt would probably diminish, if not disappear, if the change in tax were specified to be extremely large or extremely small. Suppose that the corporation income tax were increased from the current level of 38 per cent (for corporations with net income of $50,000 or more) to, say, 88 per cent, and that practically everyone expected the new rate to remain in force indefinitely. It seems unlikely that the leading firms in most industries would keep the prices of their products unchanged, in the face of so drastic a diminution of the profits available to the owners of the concerns. The tax would provide the occasion for simul-

* The author is professor of economics at Columbia University. This analysis is part of a study of the economic aspects of public finance, under the auspices of Columbia University, with the aid of a research grant from the Rockefeller Foundation.

[1] See H. R. Bowen, " Taxation of Net Income from Business," *Bulletin of the National Tax Association,* XXXI (December, 1945), 72-80, and " The Incidence of the Corporation Income Tax: A Reply [to Goode]," *American Economic Review,* XXXVI (March, 1946), 146-48; Paul W. Ellis, *The Effect of Taxes Upon Corporate Policy* (National Industrial Conference Board, 1943); Richard Goode, " The Corporation Income Tax and the Price Level," *American Economic Review,* XXXV (March, 1945), 40-58, and " A Rejoinder [to Bowen]," *American Economic Review,* XXXVI (March, 1946), 147-48; Oscar Literer, " Corporation Income Tax and Production," *Bulletin of the National Tax Association,* XXXII (April, 1946), 199-205; H. M. Groves, " Personal Versus Corporate Income Taxes," *American Economic Association Proceedings,* XXXVI (May, 1946), 241-49; C. Ward Macy, " The Corporation Net Income Tax and the Cost-Price Structure," *Bulletin of the National Tax Association,* XXX (May, 1944), 231-35, and " Corporation Income Tax: Incidence or Effects," *American Economic Review,* XXXVI (December, 1946), 903-906.

taneous, if not concerted, increases in the prices of the products of each of the leading companies, and the smaller concerns would presumably follow. This conclusion assumes that by such action the firms would be enabled to obtain larger profits before tax than they had been obtaining under their former prices, and that they had been deterred from reaching this level of profit, prior to the increase in the tax rate, by competition or fear of competition. This assumption seems to be a reasonable one, for industries where the market is shared by a number of large concerns, perhaps from three to a dozen, and by a considerable number of smaller firms.

Suppose, on the other hand, that the increase in tax rate was only from 38 per cent to 39 per cent. It seems unlikely that any of the firms would be impelled to give the change more than a passing thought, with respect to the price structure for its products.

These remarks imply that at least a part of the taxable profit, as defined in the income tax laws in the United States at the present time, is a cost that enters directly into price policy, but is only loosely linked to price policy; it may be increased or decreased by taxation slightly, perhaps even substantially, without an appreciable immediate effect on price policy, but if the change is very great, the reaction will be immediate and appreciable. The subsequent effects of the rise in prices on the volume of business are not explored here; but, in any event, such effects would not be likely to prevent the attainment of a new equilibrium in which the prices of most of the firm's products would be somewhat higher than before the tax change.

A large increase in the corporation income tax rate tends to have a more pronounced effect upon price policy than does a small increase, for still another, or supplementary reason. As the firm raises its selling prices in an effort to recoup the tax, it creates a still larger taxable profit, and therefore has to pay still more tax. Suppose that a concern is earning a profit of $1,000 before tax, and the corporation tax rate is raised from 38 per cent to, say, 88 per cent; its tax payment is increased from $380 to $880, an increase of $500. The concern now considers what it must do if it is to obtain its former profit after tax (that is, $620). It finds that it must increase its profit before tax by much more than the $500 increase in tax, for some of the increase will itself be taken in tax. In this particular case, the concern's profit before tax must increase from $1,000, not to $1,500, but to $5,166.67.[2] This spiral, or cumulative, effect operates the more strongly, in terms of what has to be done to the price structure if the tax increase is to be recouped, the higher the rate of tax after the increase has been made.

If the tax change is a reduction instead of an increase, the degree of lowering of selling prices that is consistent with just retaining the former profits after tax is greater, the higher the level of the tax rate before the change. A

[2] The formula for the increase in profit before tax that will maintain the old absolute amount of profit after tax may be stated as follows: p_o is the old profit before tax; p_n is the new profit before tax; t_o is the old tax rate; t_n is the new tax rate. For the profit after tax to remain unchanged, it is necessary that the profit before tax increase by the amount of the tax increase: $p_n - p_o = t_n p_n - t_o p_o$; therefore, $p_n = \frac{p_o(1 - t_o)}{1 - t_n}$; $p_n - p_o = \frac{p_o(t_n - t_o)}{1 - t_n}$.

drop of, say, 30 percentage points from 68 to 38 per cent would tend to allow a much greater decrease in selling prices than a drop of 30 percentage points from 38 to 8 per cent.

Ratio of Preferred Stock Dividends to Net Income

If the relevant rate of tax to profit were never any higher than 38 per cent, the issues raised in the section above would still be of some importance; but in fact the present corporation tax imposes in many instances a rate much more than 38 per cent on the profits available for the common stockholders, which is presumably the profit that is most relevant for studying the effect of the tax on price policy. This higher rate results from the existence of preferred dividend requirements. The tax is levied as a percentage of net income available for all types of stockholders; preferred dividends paid are not deductible in computing the amount subject to tax. But it is the common stockholders, not the preferred stockholders, who bear the burden of the entire tax (if it is not shifted to others). The preferred stockholders receive their fixed rate of return, and the entire tax must be met out of the proceeds available for the common stockholders. There are some qualifications to this point, but they do not seriously affect its importance for purposes of the present analysis: holders of non-cumulative preferred stock may be directly harmed by the tax in years of low income; holders even of cumulative preferred stock may find their income impaired by the tax if the dividends fall in arrears and are finally made up only in part, in recapitalization; and public utility companies are allowed to deduct preferred dividends paid, with certain restrictions, under sections 15 (a) and 26 (h) of the Internal Revenue Code, with respect to that part of the corporation income tax that is designated "surtax" rather than normal tax.

The present 38 per cent corporation income tax may therefore be much more than 38 per cent of the profit available to common stockholders (hereafter referred to as "common stock profit"). For example: if a corporation has outstanding so much preferred stock, at so high a dividend rate, that the preferred dividend requirements equal 57 per cent of the corporation's taxable income, the corporation tax of 38 per cent equals 88 per cent of the common stock profit.[3] If the preferred dividend requirements equal 62 per cent of the taxable income, the rate of tax on the common stock profit is 100 per cent. In such cases the management will surely give serious consideration to changes in price policy. The company might instead call the preferred stock and borrow an equivalent amount; but this procedure is not always practicable, especially if the preferred stock outstanding, issued perhaps many years ago at a high dividend rate, is noncallable.

If the management attempts to increase profits before tax in an effort to maintain unchanged the amount of profit available, after taxes, to the common

[3] If p is the profit before tax; t, the rate of tax on p; and e, the common stock profit (before tax); then tp is the absolute amount of tax; and the ratio of the absolute amount of tax to the common stock profit is $\frac{tp}{e}$. Hence, if t is 38 per cent, the tax is 88 per cent of the common stock profit. In the illustration above, $\frac{p}{e}$ is $\frac{100}{43}$, and t is $\frac{38}{100}$, so that the rate of tax on the common stock profit is:

$$\frac{38}{100} \times \frac{100}{43} = 88 \text{ per cent.}$$

stockholder, the conclusions reached in the preceding section apply. The entry of the preferred dividends into the analysis does not change the formula derived there. For instance, if preferred dividends equal 62 per cent of the taxable income, and if a corporation tax is introduced at a rate of 38 per cent, this tax, amounting to 100 per cent on the common stock profit, can be recouped by an increase of taxable income of 61.3 per cent.

Rate of Turnover of Equity Capital

The degree to which the corporation's selling prices must be raised, if it is to recoup the income tax from its customers, depends upon the ratio of sales to the taxable income. (To isolate the point at issue, the falling off of unit sales resulting from the rise in price is neglected.) This ratio of sales to taxable income will vary from industry to industry and from firm to firm. It will vary from industry to industry, first, because some industries habitually turn over the property that is used in the business at a faster rate than do others; the ratio of sales to such property is high in some industries, the retail grocery trade, for instance, and is low in others, as in the electric power industry. But the ratio of sales to taxable income will vary for a second reason, independent of the nature of the industry: namely, the extent to which the property used in the business is either leased by the corporation or has been purchased with borrowed money, or, on the other hand, has been purchased by money from stock issues or from retained earnings. The difference in the ratio arises from the fact that in computing taxable income the corporation can deduct rental and lease payments, and interest payments, while, as already noted, it cannot deduct dividends paid.

For purposes of the present analysis, only that part of the lease or rental payment that corresponds to an interest charge should be considered. Another part of the payment customarily goes to cover depreciation and repairs for which the owner is responsible; but these amounts would also be deductible, as such, by the corporation if it owned the property, and regardless of how the money had been obtained to purchase it. In the analysis to follow, therefore, "rental" or "lease payment" will be understood to refer only to the interest-charge element in such payment.

"Operating profit" is used here to denote the net income as ordinarily computed except that no deduction is made for either interest on debt or the interest element in the lease or rental payment. Operating profit is thus the amount that is available to compensate owners of the property that is used in the business, and to pay income tax on the corporation.

For any particular firm, the amount by which its prices will have to be raised to recoup the income tax on the corporation will be less if the corporation uses more leased or rented property, or property purchased with borrowed money.[4] For example, let the rate of turnover of the property used in the business be, in a given case, 2; that is, the property is turned over twice a year; the sales for

[4] If the analysis were broadened to include possible recoupment of the income tax that is imposed on the recipients of the interest or the rental or lease income, the relations expressed here would be replaced by more complex expressions, but the present discussion is limited to the corporation income tax and the motivation of a corporate official, in attempting to recoup the tax that is imposed directly on his corporation.

one year equal twice the value of the property employed in the business. Suppose further that the ratio of operating profit to total property used is 5 per cent; and that, of the operating profit, one-half goes in interest or rentals (as above defined). Then, if a 38 per cent corporation income tax is imposed, sales must rise by 0.766 per cent, if the profit to the stockholders after the new tax is to be as large as it was before the tax was imposed.[5] But if two-thirds of the operating profit is used to cover interest or rentals, the required increase in sales, to recoup the corporation income tax, is only 0.511 per cent.

The turnover ratio—the number of times the property used in the business is turned over in sales during the period—becomes the more important, in determining the percentage increase in sales needed to recoup the tax, as less of the operating profit is paid out in interest or rental. In the case immediately above, where two-thirds of the operating income was paid out in interest or rental, it was seen that sales would have to increase by 0.511 per cent to recoup a tax of 38 per cent, when the turnover ratio was 2. With a turnover ratio of only 1, sales would have to increase by 1.022 per cent to recoup the tax. Suppose instead that none of the operating income is paid out in interest or rental; it all goes to stockholders, preferred or common. Then, with a turnover ratio of 2, sales must increase by 1.53 per cent; while, if the turnover ratio is only 1, the necessary sales increase, to recoup the tax, is 3.06 per cent. In each illustration the needed percentage increase of sales doubles when the turnover rate is halved, but in the second illustration the needed percentages are on a higher level, owing to the absence of interest and rental payments, and the doubling of the 1.53 percentage increase is of course a more serious matter than the doubling of a 0.511 percentage increase.

Competitive Conditions: Research Required

The practical importance of the conclusions reached above depends in part on whether, in the real world of business, substantial differences exist between competing firms in the same industry with respect to their capital structures (including leaseholds and rental contracts) and with respect to the ratio of sales to property used in the business. If the competitors differ appreciably in that turnover rate, and with respect to the percentage of operating income that is paid out in rentals (as here defined) or interest, and if these two types of difference are not offsetting in nature, some of the corporations are likely to find it much more difficult than others to recoup the tax through a rise in prices, for some of them will have to raise their sales by a larger percentage than others, to recoup any given

[5] If s is the dollar value of sales;
n is the turnover ratio, that is, the ratio of sales to value of total property used in the business;
v is the rate of return on property used in the business, that is, the ratio of operating profit to value of property used in the business;
f is the ratio of interest and lease and rental payments (as defined above) to operating profit;
and the other terms are as in footnote 2 above; the percentage increase in sales necessary to cover the increase in tax is: $\frac{1}{s} \cdot \frac{p_o(t_n - t_o)}{1 - t_n}$.
If r is the profit margin on sales (ratio of operating profit to sales),

$$p_o = rs - frs = rs(1 - f).$$

But $r = \frac{v}{n}$.

Therefore:

$$\frac{1}{s} \cdot \frac{p_o(t_n - t_o)}{1 - t_n} = \frac{v}{n}\left[\frac{(1 - f)\ (t_n - t_o)}{(1 - t_n)}\right].$$

proportion of the tax. And if the firms differ with respect to the amount of taxable income that must be paid out in preferred dividends, they will be under unequal degrees of pressure to recoup the tax, whether or not they differ in their ability to recoup it. The most unfortunate of all, from a competitive standpoint, will be the corporation that has a large proportion of its taxable income earmarked for preferred dividends, with none of its operating profit going to interest or rentals, and with a low turnover rate. It will badly need to pass at least part of the tax on to its consumers, or to someone, if its stockholders are not to suffer a drastic decline in the rate of return on their investment (net, after tax), and it will be relatively unable to do so because of the large percentage increase in sales revenue that will be required to this end. And finally, if the given increase in tax, expressed as so many percentage points, comes on top of an already fairly high level of tax, all corporations will exhibit this condition of finding it more difficult to pass on the tax increment than if the increment had been added to a low tax rate, since the increase in profit needed to recoup is itself taxed, and, the higher the new total tax rate, the greater is this effect.

It should be possible, by some small-scale research with respect to corporate capital structures and turnover rates, to ascertain whether these considerations are likely to be of importance; some work is now being started at the School of Business at Columbia University on these points.

The assumption was made, at the beginning of the present analysis, that even in the short run it would be to the advantage of the owners of the corporation to have the selling prices of its products raised, if a large increase occurred in the rate of the corporation income tax. This is one of the issues that has been most discussed in recent articles on the incidence of the corporate income tax. The limited scope of the present article does not allow of an analysis of this point, except to say that the assumption made here is based upon two hypotheses suggested by common observation and by a somewhat intensive study of a few industries by the present writer. The first hypothesis, a double-barrelled one, is that the larger part of the corporation income tax is paid by corporations that (a) are engaged in monopolistic competition of the kind where most of the business in the industry is done by firms who take into account their rivals' reactions to any change in pricing policy that the firm in question may make, and (b) do not charge prices that are as high as they would charge if they were consolidated into one firm. The second hypothesis is that the corporation income tax strikes even some of the short-run costs, particularly the imputed interest and profit return on equity capital tied up in inventory, and that therefore in the absence of any immediate change in the operating profit, after the increase in corporation tax, it would be to the advantage of the owners to shrink production somewhat, fairly quickly, to release capital which they could invest elsewhere at a greater net return.

NEUTRALITY IN TAXATION

HAROLD M. GROVES *

THE term "neutrality" seldom appears in taxation literature. Most textbooks on public finance devote a chapter to the canons of good taxation. In this they do discuss what is called "equity," generally recognizing it as an important qualification of a tax. They also sometimes mention "justice" which is so described, however, as to make it mainly synonymous with "equity." Adam Smith included "certainty" among his list of canons, and he embraced in that term the idea that taxes should not be arbitrary, that is, they should be spread by general rule and not according to the whim of some monarch or his agent. It is the present author's view that the term "neutrality" (including Smith's objection to arbitrary treatment and much more) might be given a distinct place among currently recognized canons. He also holds that neutrality is a value worth more attention. Possibly not much is to be gained by launching a new ship on the already crowded sea of tax semantics. But then again perhaps the effort might contribute to clarity of thought in the field. And this is always worth doing.

Meaning of Neutrality

Certainly the reader is entitled to call forthwith for definitions. Neutrality, as the term will here be used, calls for impartiality of treatment. The partiality that we are concerned with may arise from: (1) unequal treatment of essentially similar taxpayers; or (2) the same treatment of essentially different taxpayers. Discrimination may be deliberate or inept. Its curse is removed when it is supported by adequate public purpose and ample prospect of achieving such purpose.

The term "neutrality"[1] as thus defined differs from "equity" and "justice," which include an interest in economic equality as well as in impartiality. Thus taxes are said to be equitable when they make for a more even distribution of economic reward.[2] Neutrality has to do less with the standards applied to the over-all distribution of the tax load and more with the even application of those standards once they are chosen. There is no inference of conflict between the two canons. The thought is not that taxes should be neutral *rather than* equitable; they should be both. Or perhaps more accurately: taxes should be equitable and they should deviate from neutrality only for an adequate public purpose.

To be sure, as one recalls classic literature he notes an apparent conflict between impartiality on the one hand and equity (or perhaps charity) on the other. Thus in *The Merchant of Venice* impartiality seems to have been on the

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[1] The three terms, neutrality, impartiality, and parity are used synonymously in this article.

[2] The term "justice" is sometimes used to denote or at least to include the idea of impartiality. Its usage in tax literature is vague. However, as subsequently discussed, there is no necessary departure from neutrality in the familiar statement that taxes should accord with ability to pay.

side of Shylock, and charity (equity) on the side of Portia and Antonio. And in the renowned parable of the Prodigal Son, neutrality might have allotted the fatted calf to the faithful youth rather than his wayward brother. To show the legitimate role of neutrality and the evil of partiality, the parable would need rearranging: both sons would remain faithful to the home farm but the fatted calf would still be dedicated to the exclusive benefit of one. It should become clear as we proceed that the conflict in these cases is more apparent than real.

On at least two occasions the idea of neutrality in taxation has received critical attention. The first was in *Carrier Taxation*, a report of the Board of Investigation and Research.[3] The Board had been instructed to study the application of the tax system to competing forms of transportation — trucks and busses, railroads, airplane companies, pipelines, and waterways. Congress was concerned about alleged discrimination in this area. The staff of the Board, headed by Ronald Welch, wrestled with the concept of tax neutrality, concluding that the term could best be defined to mean taxation that does not alter the allocation of resources. This idea was re-examined by a committee of the National Tax Association under Carl Shoup as chairman.[4] The committee accepted Dr. Welch's definition in the main, but pointed out that any test as to the reallocation of resources should involve a substantial analysis of shifting and incidence. What is, or at least appears to be, a discriminatory tax might result in no reallocations if the demand and supply factors were highly inelastic.

Dr. Welch was confronted with a difficult task of measurement and comparison. His assignment called for an answer to the question: which of several competing industries are relatively overtaxed and which are "getting off easy"? The tax system included some taxes applicable to only part of his field and other compensating levies reaching other lines of business. It was hoped that he could produce answers that were objective and unimpeachable. But he inevitably became involved in an issue that has no unimpeachable answer: on what bases should taxes be distributed in the first place? Were there a universally acceptable answer to this question, most of the controversy in the tax field could be laid to rest forthwith. Making the best of a bad situation, Dr. Welch turned in an excellent factual and analytical report; in addition, he provided several sets of answers, hedging each with proper skepticism.

In the course of his analysis Dr. Welch did suggest that there are clear cases of discrimination within given areas. This paper is an expansion of this suggestion.

The difference between macro- and micro-analysis in this matter can be illuminated in a simple illustration. Take the case of three merchants: the first has much capital but a slow turnover and very little net profit; the second has little capital but a high turnover and again very little profit; the third has little capital and turnover but contrives to make a substantial net income. The first complains about the property tax, the second about the sales tax, and the third about the net income tax. Under

[3] House Document 160, 79th Congress, 1st Session, 1944.

[4] *Proceedings of the National Tax Association*, 1946, pp. 71-103.

any given tax system, which one is overtaxed? We need not conclude that public finance must ignore such questions but in the present state of our science one cannot hope to find an answer that will satisfy all the merchants nor all the other critics. Shifting to the micro-approach, however, we might hope to get agreement on the proposition that any property tax which measures taxable inventories on the basis of what merchants have on hand at the end of a particular day, such as May 1, is discriminatory and unfair.

It will not do to conclude, however, that our interest is confined to the area where all is objective and where reasonable men may not differ. The distinction between criticism of a tax standard and complaint about its uneven application is not very great, and the two shade imperceptibly into each other. Particularly is this true where neutrality requires that unlike things be treated distinctly. The question then arises as to what is a significant difference for tax purposes. A poll-tax enthusiast might say that every individual is a head and that while there are considerable differences among heads they are of a sort that ought to be disregarded. Moreover, conceding the validity of exceptions to neutrality where the public interest requires, we must expect to confront all sorts of opinions as to what is in the public interest. Nevertheless it is believed that the idea of neutrality as here conceived can be established as a useful tool of analysis for many concrete tax situations.

The term neutrality will not here be confined to cases where resource reallocation occurs. An unneutral tax will usually result in a deviation from an existing pattern of resource utilization and often also from an optimum pattern. The latter is one reason why a clear departure from neutrality should carry a burden of proof. But the author is disinclined to strain the customary usage of the term neutral to exclude from consideration cases where such inelasticities prevail that no change in the pattern of resource utilization may be expected no matter how much tax discrimination occurs.

Applications of the Neutrality Canon

We are now ready to examine some of the tax problems in which considerations of neutrality, as above defined, do or should play a part. Let us start with the field of utility taxation. Here the question arises as to whether the principal levies should be so integrated with general levies that parity of treatment can be maintained. At one time, in Wisconsin, Robert M. Lafollette, Sr., made the issue of tax parity for railroads the cornerstone of a new political movement. The fact that railroads were "undertaxed" as compared with farmers and merchants was to him a moral issue of the highest order and he carried the State with him in this view.

Some states apply to railroads a gross income tax in lieu of a property tax. A major criticism of this alternative is that it involves difficulty in maintaining parity. This is because rates on gross income show great inertia and cannot be changed from year to year along with the property tax rate. Moreover, a tax on gross income carries a denominator differing from that on property; translation from one to the other is difficult.

But does it make any difference whether or not parity is maintained? Canada apparently takes no pains at all to equilibrate railroad and other taxes.

And England has largely derated business and agricultural property for the application of local rates. The action in Britain could be defended as an effort to strengthen British industry in foreign competition. And the problem there and elsewhere is complicated by the fact that business taxes are in large part passed on to consumers. Nevertheless, it requires no great stretch of the imagination to picture the uproar which would greet any suggestion for untaxing railroads in the United States. Perhaps the factor of parity is overrated in consideration of matters like this, but no one can doubt that it is real and important.

Or take the case of taxing life insurance companies. Put the question to a class of students: Why should we tax life insurance companies, particularly those organized on the mutual plan? Cogent reasons for not taxing such concerns will be advanced; the incidence will probably lie with the policyholders; many of these are poor people and insurance represents their meager savings; some, to be sure, are not so poor, but these can be adequately taxed through the personal net income tax; the insurance business promotes thrift among those who should be encouraged to save; it reduces charity and relief problems when families encounter misfortune; and so on. To which comes back the lone but irresistible argument: insurance companies should be taxed because everybody else is taxed. To exempt them would be a departure from parity.

Consider the field of mine taxation. In several states, governors have been made or broken by their stand on "making the mines pay their fair share of taxes." Severance taxes have many advantages over ad valorem levies, but the latter rest solidly upon the fact that they are easily and automatically adjusted to provide neutrality with levies on other business.

The general gross income tax is bedeviled with unneutralities. It is a " middleman's tax " favoring integrated concerns (resulting from vertical combination) over so-called independents. Moreover it discriminates against commodities that require many steps in processing and distribution as compared with those that do not. In the author's mind these are major reasons for preferring a retail sales tax.

The fact that a tax is shifted to the consumer does not mean that it escapes the criterion of neutrality. A tax can be as unneutral among consumers as among producers. If the consumption of commodity A is taxed and that of commodity B passed by, a consumer whose tastes run to A will be penalized. The special excises are on the defensive at this point. To be sure they can be defended in the name of legitimate social purpose—namely adequate revenue at minimum cost of collection and public reaction. But not all of them can summon even this defense.

Should a tangible general property tax include accessible personal property, or only real estate? And if the latter, does it make any difference, except in yield, if many categories of property (such as lodges) are exempt? There may be plenty of good reasons why personal property should be exempt, but the parity consideration on the other side is entitled to weight. Why should A whose wealth is in real estate be taxed more than B whose wealth is in movable machinery? Of course, the consideration of parity here is complicated by the diverse incidence of different parts of the property tax. Perhaps the consumer pays the levy on the store building and the one on the merchant's inventory, but not the one on the store site. As

previously stated we cannot escape the issue of neutrality by introducing claims of shifting. But we can say that taxes which are irregularly and capriciously shifted rate a low score as to neutrality.

The corporate net income tax field is loaded with issues of tax parity. The business man today who makes his decisions solely on the basis of business facts without regard for tax implications is surely on his way out. Space does not permit an elaborate analysis of all the respects in which his decisions should be shaped to suit the tax system. One of the most frequently discussed is the so-called double taxation of corporate earnings and this will serve as an illustration. The earnings paid out to bondholders are deductible to the corporations; those paid out to stockholders are taxed twice, once to the corporation and once to the stockholder. Why should this continue? It can be answered that many stockholders are rich people. Or if this seems inadequate it can be argued that the double tax is a means of preventing redundant savings. But is it the equity capital that is redundant or general savings or neither? It is not our purpose here to rehash an old argument. Rather it is to cite a case where neutrality may be an important value and where it is certainly an issue.

The field of unemployment compensation offers an interesting illustration of the use of the neutrality principle to support differentiation. The proponents of experience rating conceive unemployment compensation as an attempt to allocate a "social overhead cost" to industry. Now some industries are unstable, inherently or otherwise; they require the maintenance of a labor reserve for use in peak seasons and years. It is contended that these industries or the consumers of their products should pay such costs as can reasonably be allocated to them. This is being fair both to the producers and to the consumers in competing industries and is also in accord with the idea of promoting maximum consumer satisfaction. If those interested in fuel oil pay costs attributable to coal, they have a right to complain. Of course, here as elsewhere the presumption in favor of neutrality can be rebutted. But the presumption is there.

Justified and Unjustified Departures from Neutrality

Of course, very clear instances of indefensible unneutrality arise in the case of double counting. Where a railroad bridge is assessed twice for property taxation, once locally, and once as a part of the state assessment of the railroad as a whole, any lawyer could convince any court that an injustice has been perpetrated. Similarly where a taxpayer whose business crosses state lines pays more (or less) taxes than a similar one confined within state boundaries, other things being equal, there is a clear case of injustice, albeit perhaps unremediable. On the other hand, not all cases of multiple taxation involve discrimination. There is no necessary unneutrality in taxing a motorist once for a license and again on his use of motor fuel. Nor is there any problem of this sort in overlapping taxation by two layers of government such as federal and state.

Unreasonable classification also involves clear cases of unneutrality. It would obviously be unneutral to tax those whose names begin with the letter *A* more, other things being equal, than those whose names begin with *B*.

Evasion and avoidance are large problems for those who are concerned about neutrality. What appears to be the best tax in the world will and should lose caste rapidly if it cannot be enforced beyond say an 80 per cent level.

And a levy that is unimpeachable in its objective is nonetheless vulnerable if it cannot be defined so that those in essentially similar circumstances contribute alike. To be sure, there are those who look only to the nominal distribution of a tax (rates) without regard to the effective distribution. There are those who are unconcerned over the fact that a person earning a million dollars a year one way pays an 85 per cent Federal tax while another making the same by a different route (capital gains) pays less than a third as much (and possibly escapes taxation entirely). Insensitivity to the neutrality value is common enough. But blindness of this sort need not be condoned.

All of this, of course, is not to argue against differentiation in public finance. Indeed the art and science of taxation seems concerned with little else. But differentiation can never be its own justification; it has to defend itself and it will and should be judged by the quality of its defense.

Professor John R. Commons once wrote:

> Taxation, then, is the most pervasive and privileged exercise of the police power.... Even when not consciously intended to be regulative, taxes nevertheless regulate, for they like the protective tariff determine the directions in which people may become wealthy by determining the directions in which they may not become wealthy. They say to the business man: Here is profit, there is loss. It is impossible to avoid these effects of taxation, therefore impossible to escape the police power of taxation, therefore impossible to look upon taxes of any kind whatever as merely a means of obtaining revenue according to any principle of equality, or ability to pay, or accumulation of wealth, or any standard that looks solely to the acquisitions of the past. [5]

Professor Commons supported the unneutral application of the property tax, favoring improvements as against land. He argued that land is an especially suitable object for taxation because its supply is peculiarly inelastic and because its values are of community origin. We are not interested here in either defending or attacking his conclusion. We only wish to point out that he had the burden of proof and recognized as much. If he carried it successfully, he established his case.

The Fathers who sought to write the general property tax into state constitutions probably aimed at neutrality. Closer than we to the special edicts of the old British kings, they were greatly concerned about the equal application of the tax laws. They probably ranked neutrality in taxation close behind the proposition that "All men are created equal." But they confused neutrality with uniformity and involved themselves and future generations in no end of trouble. A uniform property tax as contemplated by the state constitutions involves a high degree of partial double counting. And it leaves no scope for differentiation even though the public interest may require it. Of course, differentiation could favor private rather than public interest. The Fathers closed the door to abuse (except usually for freedom to exempt) but in so doing they also shut off possibilities of wise differentiation. Their error lay in too great skepticism of the wisdom of legislative bodies and not enough appreciation of the importance of legislative freedom.

[5] *Institutional Economics* (New York: Macmillan, 1934), p. 820.

Of course, there is something to be said for the Fathers' skepticism. It is doubtful indeed if there ever was an American tariff law drawn primarily in the public interest. Congress, as constituted, is probably incapable of adopting such a law and it is highly to its credit that it has recently come to recognize this fact, delegating part of its tariff making power to the President.

The progressive principle in income and death taxation may not be a departure from neutrality though it is sure to seem so to its opponents. If the progressive scale varies in accord with ability to support government, it is strictly in accord with impartial treatment. On the other hand progressive taxation may be regarded as a departure from neutrality, supported by the social interest in equality. The latter defense is regarded by many as more realistic and seems to have been gaining ground. Of course, either defense is arguable.

The distinction between strict impartiality and departure from impartiality *in the public interest* is very slight. A good parent can maintain his reputation for "justice" both in his family and his community as long as his decisions are in the best interests of his family as a whole. But let his special treatment turn on personal bias or whim or miscalculation and his reputation deteriorates rapidly. So it is with the state.

Conclusion

The case for impartiality in taxation hardly needs elaboration. It is, of course, an end in itself. It is important to the morale of taxpayers, any of whom can be discouraged in the game of life if the umpire is or appears to be particularly biased against him. Neutrality is important for the optimum allocation of resources and the maximum satisfaction of consumers: not that legislators can never improve upon the "natural order" in this respect, but such improvement will not be attained by deliberate favoritism or bungling; not that the even application of tax laws can ever be perfectly achieved—a margin of tolerance is conceded in what is sometimes called "rough justice." But most laws can be made to operate more impartially. In these days when some would justify almost any tax merely because it comes out of the rich, or merely because it does not, the values of neutrality are worth stressing.

Abba P. Lerner has recently attracted wide attention by his proposition that "The purpose of taxation is never to raise money but to leave less in the hands of the taxpayer." In other words, taxes exist only to control inflation and deflation. The author would not quarrel with the statement insofar as it merely calls attention to the need of considering the cyclical effects of taxation and their improvement. But surely the tax system is not one that can be turned on and off like a faucet. The institutional aspects of taxation have been developed at too great pains to be thus summarily relegated. What about the fairness of taxing A to the hilt because he happens to make his fortune in 1950 and letting B go free because he comes into his own in 1955?

The egalitarianism to which progressive taxation aspires has no terrors at all for the author. It is but the maturing of a social conscience holding that the strong must help the weak. But the uneven application of the tax laws smacks of tyranny. It is dangerous to rest on the false assumption that tyranny was killed and buried many years ago.

COMPARATIVE TAX LOADS ON RAILROADS IN NINE SOUTHERN STATES

JAMES W. MARTIN [*] and BEULAH LEA PARDUE [†]

INVESTIGATORS have employed two distinct methods of comparing relative railroad tax loads. One of these is to use a selected tax system and compare the taxes paid in the various states with those that would have been paid under the selected system. This method is intended to give a measure of overtaxation or undertaxation in terms of an ideal or "standard" tax system or of the tax system of a particular state. The use of any adaptation of this method requires the exercise of subjective judgments. The second method, which is to compare amounts of taxes per unit of receipts or of other measures related to taxable capacity, is, therefore, the more objective approach to relating the taxes paid by railroads in one state to those in other states.

Comparative Railroad Tax Loads in Nine Southern States [1]

Table 1 compares the relative tax load of railroads in nine southern states by using operating property, railway operating revenue, and net railway operating income as measures of comparative taxation for 1940 and 1945. These data reveal that Virginia, Tennessee, and Kentucky are the relatively low-tax states, and Florida and the Carolinas are the exceptionally high-tax states of the group if taxes are compared with operating property or net railway operating revenue. Kentucky and West Virginia join the group of relatively high-tax states if taxes are related to railway operating revenue.

Such state-by-state comparisons may

TABLE 1

TOTAL STATE AND LOCAL RAILROAD TAXES INCIDENT TO OPERATIONS * PER $100 RAILWAY OPERATING PROPERTY, RAILWAY OPERATING REVENUES, AND NET RAILWAY OPERATING INCOME OF SELECTED RAILROADS, BY STATES, 1940 AND 1945

State	Per $100 Operating Property	Per $100 Railway Operating Revenue	Per $100 Net Railway Operating Income
		1940	
Alabama	$1.73	$6.08	$29.06
Florida	2.76	6.21	63.33
Georgia	2.04	4.53	37.30
Kentucky	1.12	5.82	18.94
North Carolina	3.21	8.09	56.88
South Carolina	2.40	5.71	43.76
Tennessee	1.07	3.28	17.70
Virginia	0.92	4.53	15.29
West Virginia	1.34	8.22	22.44
		1945	
Alabama	$1.37	$3.71	$20.08
Florida	1.60	4.08	23.73
Georgia	1.81	3.61	26.64
Kentucky	1.24	4.95	20.68
North Carolina	2.91	6.55	44.43
South Carolina	2.25	4.75	33.38
Tennessee	1.16	3.04	17.67
Virginia	1.10	3.77	17.74
West Virginia	1.41	6.56	23.51

Source: Computed from data supplied by the railroads.

* Pay roll and sales taxes are not included.

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[1] In the second part of this paper the authors outline the methods employed here and, by so doing, indicate the limitations of the data.

with good reason take into account relative capacity of the state population to pay taxes, as well as the amounts paid by the carriers. According to this point of view, one state, as compared with other states, may spend a greater and another a lesser proportion of all income payments through government; if so, it may be contended that the states should expect railroads to pay taxes amounting to a similarly greater or lesser percentage. An adjustment of the data in Table 1 to reflect this consideration is made in Table 2. Virginia, the state having the lowest level of taxation according to the first column of Table 1, is made the base for the comparison. The last two columns show the relationships among these states' railroad taxes in the light of this adjustment. Comparison of the figures before and after the adjustments (the first two and the last two columns of figures in Table 2) shows that the ranks of various states are little affected, though the difference between the apparent tax load in Virginia, the state having the lowest taxes, and in other states is not as great after the adjustment, except in the case of Georgia and Kentucky in 1940. The adjustment actually shows a lower apparent tax load in Tennessee in both 1940 and 1945 and in Kentucky and West Virginia in 1945 than in Virginia.

The first two columns of Table 2 show the relative amounts of state and local taxes actually paid in each of these several states. The last two show the amount that would have been paid if, in each other state, the actual payments were adjusted to bring them to a level of payments (in comparison with income) on a parity with those in Virginia. But one may take the position that the actual payments should rather be adjusted to take account of the

TABLE 2

RELATIVE RAILROAD TAX LOADS PER $100 OF CARRIER PROPERTY BY STATES IN THE LIGHT OF ADJUSTMENTS TO TAKE ACCOUNT OF VARYING RATIOS OF STATE AND LOCAL TAXES TO INCOME PAYMENTS, 1940 AND 1945

State	State and Local Railroad Taxes Incident to Operations per $100 of Operating Property		Ratio of Total State and Local Taxes to Income Payments				Relative Tax Load in the Light of Adjustments to Virginia Ratio of Taxes to Income Payments	
			Unadjusted (per cent)		As an Index (Va. = 100)			
	1940 (1)	1945 (2)	1940 (3)	1945 (4)	1940 (5)	1945 (6)	1940 [a] (7)	1945 [b] (8)
Alabama	$1.73	$1.37	10.62	5.05	117	109	$1.48	$1.26
Florida	2.76	1.60	12.67	5.49	140	119	1.97	1.34
Georgia	2.04	1.81	9.03	4.73	100	102	2.04	1.77
Kentucky	1.12	1.24	5.23	5.64	58	122	1.93	1.02
North Carolina	3.21	2.91	11.85	6.60	131	143	2.45	2.03
South Carolina	2.40	2.25	11.38	6.17	126	134	1.90	1.68
Tennessee	1.07	1.16	11.11	5.18	123	112	0.87	1.04
Virginia	0.92	1.10	9.05	4.62	100	100	0.92	1.10
West Virginia	1.34	1.41	11.32	6.38	125	138	1.07	1.02

Source: Computed from data supplied by the railroads and information secured from Charles F. Schwartz and Robert E. Graham, Jr., "State Income Payments in 1945," *Survey of Current Business*, August, 1946, p. 20.

[a] (Column 1 ÷ Column 5) × 100.

[b] (Column 2 ÷ Column 6) × 100.

greater use of property taxation in some states than in others. This is particularly important in the case of railroad taxation, it may be contended, because in this business a great amount of fixed property is essential to the conduct of the business. Thus, property taxes bulk large. If property taxes are a minor element in state and local taxation, as in Alabama (see Table 3), it is reasonable to expect that they will be comparatively low on railroads. If property taxation bulks large in general state policy, the state may be expected to make comparatively large demands on railroads. The last two columns of Table 3 reflect an adjustment in relative property taxes to take account of this element in general state policy.

In the first two columns of Table 4, a comparison is shown in terms of relative property and business taxes combined after the adjustment made in Table 3. The adjustment makes the difference smaller between Florida and, in 1940, South Carolina taxes and Virginia taxes. It tends to reduce the variation in apparent tax loads as to some states but to enlarge the gap between the low-level states and Alabama, Georgia, North Carolina, West Virginia, and, in 1945, South Carolina.

Although there is something to say for the view that an adjustment should be made to bring railroad property taxation in line with general property tax policy, the case for this adjustment is less persuasive than that for the adjustment for differences in income payments, previously computed in Table 2. A state *may* reasonably adopt a low-rate property tax for general application and yet exact a high rate from railroads—or *may* adopt a reverse policy.

Conceivably one may take the position

TABLE 3

RELATIVE RAILROAD PROPERTY TAXES AFTER ADJUSTMENTS IN OTHER STATES TO REFLECT VIRGINIA RELATION OF PROPERTY TAXES TO TOTAL TAXES, 1940 AND 1945

State	Average State and Local Property Tax Incident to Operations per $100 Railway Operating Property		Property Tax per $100 of Total Tax Revenue in State		Index of Property Tax per $100 of Total Tax Revenue in State (Va. = 100)		Relative Railroad Property Tax per $100 Operating Property After Each Other State Is Adjusted to General Virginia Property Tax Policy	
	1940 (1)	1945 (2)	1940 (3)	1945 (4)	1940 (5)	1945 (6)	1940 [a] (7)	1945 [b] (8)
Alabama	$1.33	$0.84	$30.49	$23.83	72	67	$1.85	$1.25
Florida	2.65	1.54	46.02	39.79	109	111	2.43	1.39
Georgia	1.99	1.33	40.68	32.61	96	91	2.07	1.46
Kentucky	1.04	1.10	47.32	43.90	112	123	0.93	0.89
North Carolina	1.97	1.15	35.72	26.64	85	74	2.32	1.55
South Carolina	1.93	1.08	42.88	32.28	101	90	1.91	1.20
Tennessee	1.00	1.03	46.83	38.45	111	107	0.90	0.96
Virginia	0.60	0.60	42.26	35.78	100	100	0.60	0.60
West Virginia .	0.74	0.91	31.81	28.63	75	80	0.99	1.14

Source: Computed from data supplied by the railroads and information secured from Bureau of the Census, *Governmental Finances in the United States: 1942; Financial Statistics of States: 1940;* and *State Finances: 1945.*

[a] (Column 1 ÷ Column 5) × 100.

[b] (Column 2 ÷ Column 6) × 100.

that an adjustment should be made both for differences in property tax policy and for differences in general taxable capacity. A computation, the results of which are shown in the last two columns of Table 4, is made to facilitate such a comparison. Examination of the first two columns of Table 2 and the last two columns of Table 4 brings out some rather striking changes in the relative total railroad tax load per $100 of operating property after adjustments for differences in both the ratio of total taxes to income payments and in property tax policy. Only Tennessee in 1940 and both Tennessee and Kentucky in 1945 show an apparent decrease in tax load after the adjustments. In 1940, both Kentucky and West Virginia show increases in tax load after the adjustments, but the increase is greater in the case of Kentucky. Because of this greater increase, Kentucky's apparent load after the adjustment is greater than the load in West Virginia; before the adjustment, West Virginia appeared to have relatively higher railroad taxes than those in Kentucky. Similar changes in apparent relative tax load occurred in 1945 between Florida and Alabama, West Virginia and Alabama, and Kentucky and Tennessee.

TABLE 4

RELATIVE RAILROAD TAX LOAD AFTER ADJUSTMENT IN OTHER STATES TO REFLECT VIRGINIA RELATION OF PROPERTY TAXES TO TOTAL TAXES AND TO VIRGINIA RATIO OF STATE AND LOCAL TAXES TO INCOME PAYMENTS, 1940 AND 1945

State	Relative Total Railroad Taxes per $100 Railway Operating Property After Each Other State Is Adjusted to General Virginia Property Tax Policy		Index of Relative Total Railroad Taxes After Each Other State Is Adjusted to Virginia Ratio of Taxes to Income Payments (Va. = 100)		Relative Total Railroad Tax Load per $100 Operating Property after Adjustment for Both Income Payments and Differences in Property Tax Policy	
	1940 [a] (1)	1945 [b] (2)	1940 (3)	1945 (4)	1940 [c] (5)	1945 [d] (6)
Alabama	$2.25	$1.78	161	115	$3.62	$2.05
Florida	2.54	1.45	214	122	5.35	1.77
Georgia	2.12	1.94	222	161	4.71	3.12
Kentucky	1.01	1.03	210	93	2.12	0.96
North Carolina	3.56	3.31	266	185	9.47	6.12
South Carolina	2.38	2.37	207	153	4.93	3.63
Tennessee	0.97	1.08	95	94	0.92	1.02
Virginia	0.92	1.10	100	100	0.92	1.10
West Virginia	1.59	1.64	116	93	1.84	1.52

Source: Computed from Tables 2 and 3.

[a] (Column 1 of Table 2) — (Column 1 of Table 3) + (Column 7 of Table 3).

[b] (Column 2 of Table 2) — (Column 2 of Table 3) + (Column 8 of Table 3).

[c] (Column 1 ÷ Column 3) × 100.

[d] (Column 2 ÷ Column 4) × 100.

Methods of Computing Comparisons

The coverage of data employed in previous paragraphs and in the tables of this paper is subject to one distinct limitation. The statistics were originally developed for purposes of the report by the Research Director of the Virginia Public Service Tax Study Committee,[2] and in consequence the data refer only

[2] *Taxation of Public Service Corporations in Virginia* (Richmond, November, 1947).

to railroads operating in Virginia.[3] For reasons peculiar to Virginia operations, the Louisville and Nashville was not included, and of course data for interstate carriers operating in southern states other than Virginia which have no lines in the Old Dominion are excluded. In all probability none of the omissions except that of the Louisville and Nashville would introduce a source of possible error of any considerable quantitative importance. However, the picture for some states might be somewhat altered by omission of statistics for decidedly weak carriers. In Tennessee, for example, the introduction of data respecting the taxes of the Frisco, the Middle Tennessee, the Mobile and Ohio, and the Nashville, Chattanooga, and St. Louis might influence the showing for that state. Technically, therefore, the data presented tend to throw some light on the comparative level of taxation in the several states but to answer more specifically the question posed in the Virginia resolution.[4]

Railway operating revenues and net railway operating income, standard accounts as prescribed for railroad reports to the Interstate Commerce Commission, require no special definition. It should be noted, however, that railway operating revenues are allocated among states for present purposes exactly as for the carriers' own management purposes. The techniques vary from road to road. It should also be noted that net railway operating income is allocated in the same way as property. The determination of property values used as measures of taxable capacity does require some explanation. Briefly, the unit valuations of each railroad's property made for use in this study are determined by computing an average of the capitalized earnings (weighted two) and of net stock and debt values (weighted one). The technical difficulty of employing capitalized earnings is less, particularly in the case of these roads, than that incident to using stock and debt values—hence the double weighting of capitalized income as compared with the stock and debt summation.

The rates of capitalization applied to the net railway operating income, as reported to the Interstate Commerce Commission, are 5.50 per cent for the years 1936-40, and 5.75 per cent for the years 1941-45. These rates of capitalization were selected on the basis of detailed studies conducted in the mid-1930's and general knowledge of the capital-market situation later. The results of the earlier studies suggested a rate of about 5.75 per cent. The earnings rate on the current value of railroad securities declined during the late 1930's and then increased during the war period. The rates selected, therefore, appear to be suitable rough averages for the years used in these illustrations. A five-year basis of capitalization is used for 1940 and a ten-year basis for 1945.[5]

The method of arriving at the value of stock and debt employed in these

[3] Atlantic Coast Line; Chesapeake and Ohio; Clinchfield; Norfolk Southern; Norfolk and Western; Richmond, Fredericksburg, and Potomac; Seaboard; Southern; and Virginian.

[4] Acts of the Regular Session of the General Assembly of Virginia, 1946, House Joint Resolution Number 72. This resolution called for a comparison of Virginia taxes on railroad companies with taxes imposed on these companies in other states in which they operate.

[5] The method followed would overvalue most of the southern roads, but perhaps not the average of these particular ones.

computations involves a summation of the value of all stocks, bonds, and current liabilities. The values used for current liabilities are those which the companies reported annually to the Interstate Commerce Commission. The accounts included in the standard classification of current liabilities have changed from time to time, but the only important change during the period 1936-45 was the transfer of " taxes accrued " to the current liabilities classification. An adjustment, therefore, was made to show taxes accrued as a current liability for all years, 1936-45. Nonoperating property was deducted, largely on the basis of estimated value.

Allocations to the various states are by the use of a composite of seven selected factors. Track-mileage, road-mileage, and reproduction-cost (less depreciation) fractions are averaged in one group; car- and locomotive-miles, traffic units, gross receipts, and the average of tons of originating and terminating traffic fractions are averaged in another group. Use of the mean of the two groups as the composite factor allocates one-half of the value among the states on the basis of property factors and one-half on the basis of operating or use factors. The allocated values for all railroads operating in a particular state are the total operating property values used for comparing tax burdens among the states.[6]

[6] As has been implied already, there is no suggestion that the result of these techniques represents an appraisal of each carrier's property.

THE ADMISSIONS TAX

GEORGE E. LENT*

THE wartime development of the tax on admissions into one of the major excises of the Federal Government has aroused considerable interest in its revenue possibilities for local governments. Ideally adapted to local conditions, it has already been adopted by many communities and is under serious consideration by others as a supplementary source of revenue. However, prior exploitation of this field by the Federal Government, at the present rate of 20 per cent, and by many states at rates as high as 10 per cent, raises a real question of possible conflict. It is the purpose of this article to explore the possibilities of inter-governmental coordination in this important area. First, however, it is believed desirable to review Federal experience in the administration of the admissions tax and to appraise the economic and equity characteristics of the tax. Such analysis should provide a better basis for the enactment of local taxes, and for the development of a program of Federal-local tax coordination.

1. THE FEDERAL TAX ON ADMISSIONS

The Tax Base

The present Federal tax on admissions [1] has retained substantially the same form in which it was first enacted by the Revenue Act of October 3, 1917. This act included a tax on general admissions; leases of seats and boxes; and admissions to roof gardens, cabarets, and other places of entertainment. While a legitimate member of the family of admissions taxes, the cabaret tax is not included in the present discussion. The cabaret tax was designed to reach payments for entertainment where the price of admission is included in the charge for food, beverage, and service.[2] Because of the difficulty of segregating the taxable "admission," the base was arbitrarily fixed at 20 per cent of the total bill, exclusive of the "cover" charge subject to the general admissions tax. This was changed in 1941 to a flat charge on the entire bill. In 1918, the admissions tax was supplemented by special excises on tickets sold by proprietors and brokers for amounts in excess of the established price. These amendments were regulatory in character and have never yielded any appreciable revenue.

The general admissions tax is levied on the price which must be paid to gain admission to any place. Admissions to places of amusement constitute the general class of sales subject to tax. In general, the tax is based on the established price for each performance. Where free admissions, i. e., complimentary tickets, or reduced charges are allowed, the amount of tax is based on the full price charged to others for similar accommodations.[3] Exceptions are

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[1] *Internal Revenue Code,* Sec. 1700.

[2] In 1941, the law was amended to read, "refreshment, service, and merchandise," *Revenue Act of 1941,* Sec. 542 (e) (1).

[3] This policy was introduced in the Revenue Act of 1932.

made for children under twelve; *bona fide* employees; reporters, technicians, etc. engaged for special duties; and servicemen in uniform. In these cases free admissions are tax free and the tax on reduced rates is based on the reduced price.[4]

Tax Rates and Price Exemptions

Until 1943, the basic rate on general admissions remained unchanged at 1 cent for every 10 cents or fraction thereof.[5] The wartime rate was increased to 1 cent for each 5 cents or major fraction thereof, where it remains today.[6] Admissions sold by proprietors for amounts in excess of established prices have been taxed at 50 per cent of the excess from 1917 until the present day. The excess of ticket broker sales above established prices is now subject to a rate of 20 per cent (formerly 11 per cent).

Although the tax rate remained unchanged for a period of twenty-five years, the history of admissions taxes has been characterized by periodic changes in price exemptions, as is shown by Table 1.

Where the price of admission exceeded the exemption, the entire amount was subject to the tax. A general price exemption policy was first introduced in the Revenue Act of 1921. Successive increases in the price limit accompanied the general tax reduction program of the 1920's until an exemption of $3.00 was reached in 1928. This amounted virtually to a repeal of the admissions tax until 1932, when it was revived by a reduction in the exemption to 40 cents. The defense tax program resulted in a lowering of the exemption to 20 cents in 1940 and its final elimination in the following year. No consistent policy can be inferred with respect to the purpose of price exemptions except that they reflected the changing standards of what constistuted "luxury" entertainment in consideration of the changing fiscal requirements of the Federal Government. They also measured the success with which the efforts of the powerful movie industry were rewarded by the Administration and Congress.

TABLE 1

General Admissions Tax Exemptions, Selected Revenue Acts, 1917-1941

Revenue Act	Exemption
1917	$.05-.10 [a]
1918	0
1921	.10
1924	.50
1926	.75
1928	3.00
1932	.40
1940	.20
1941	0

Source: Treasury Department, *Federal Tax Rates, 1913-1940,* pp. 496-97; *Revenue Act of 1941,* Sec. 541.

[a] Admissions of 5 cents or less and of 10 cents or less in the case of amusement parks, rides, etc. were exempt in the 1917 act. Admissions of children under twelve years of age were taxed at 1 cent in 1917; at present they are tax free if the price is under 10 cents.

Revenue Yield

Between 1932 and 1947, total collections from the general admissions tax increased from $1.5 million to $392.9 million, as is shown by Table 2.

In the fiscal year 1947, collections from the cabaret tax of $63.4 million raised the total yield of admissions taxes to

[4] *Revenue Act of 1941,* Sec. 541.

[5] In 1928 a special tax of 25 per cent was levied on prize fight admissions if the amount was over $5.00. This tax was repealed in 1932.

[6] *Revenue Act of 1943,* effective April 1, 1944.

$456.2 million, compared with a total of $1.9 million in 1932. This phenomenal increase can be attributed to three factors—expansion of the national income, doubling of the tax rate, and, most important, final elimination of the price exemption, which amounted to $3.00 in 1932. The effect of the removal of the exemption can clearly be seen by the increase in revenue to $14.8 million in 1933 with the reduction in the price exemption to 40 cents. The reduction from 40 cents to 20 cents in 1940 more than tripled revenues, increasing them from $20.3 million in 1940 to $68.6 million in 1941. The elimination of the price exemption in 1941 largely accounted for an increase in revenues to $107.6 million in 1942. Since then increases in admissions tax collections can be attributed to the doubling of the rate in 1943 and to greatly increased expenditures for entertainment.

TABLE 2

General Admissions Tax Collections,[a] Fiscal Years 1932-1947
(Thousands of dollars)

Fiscal Year	Amount
1932	$ 1,560
1933	14,770
1934	14,018
1935	14,425
1936	15,773
1937	18,185
1938	19,293
1939	18,028
1940	20,264
1941	68,618
1942	107,632
1943	138,054
1944	178,563
1945	300,589
1946	343,191
1947	392,873

Source: Joint Committee on Internal Revenue Taxation, *Internal Revenue Collections from Specified Sources for the Fiscal Years 1918-1938; Annual Reports of the Commissioner of Internal Revenue; Treasury Bulletin*, U. S. Treasury Department.

[a] Excluding cabaret tax.

Major Sources of Revenue

The scope and variety of entertainment covered by the Federal tax on admissions is indicated in Table 3. In 1945, the latest year for which detailed estimates are available, total paid admissions amounted to about $1.5 billion.[7] Of this amount, moving picture

TABLE 3

Paid Admissions: 1945
(Millions of dollars)

	Amount[a]	Per Cent
Theater admissions		
Motion picture theaters	$1,125	76.6
Legitimate theaters and opera	84	5.7
Total, theater admissions	$1,209	82.3
Spectator sports		
College football	$ 43	2.9
Professional sports	31	2.1
Other amateur sports	30	2.0
Horse and dog race tracks	19	1.3
Total, spectator sports	$ 123	8.4
Other		
Dancing, riding, skating, and swimming places	$ 54	3.7
Entertainment of non-profit organizations (except athletics)	52	3.5
Amusement devices and parks	24	1.6
Ticket brokers, markups	6	0.5
Total, other	$ 136	9.3
Total paid admissions	$1,468	100.0

Source: *National Income*, supplement to *Survey of Current Business*, U. S. Department of Commerce, July, 1947, p. 43.

[a] Including admissions tax.

[7] The Commerce Department estimates of paid admissions fall short of an estimate of $1.6 billions made on the basis of tax collections for the calendar year 1945. The estimates of the Department of Commerce for each category are probably subject to some error with respect to their coverage by the admissions tax, but this is believed to be slight.

attendance contributed 76.6 per cent. While somewhat less important than claimed by spokesmen for the industry —85 per cent[8]—the dependence of the revenue yield on movie admissions has, nevertheless, been very substantial, ranging between 75 and 80 per cent over a long period of time. The legitimate theater and opera contributed an additional 5.7 per cent in 1945. More than four-fifths of total tax collections were, therefore, realized from theater admissions. In 1945, spectator sports accounted for 8.4 per cent of total paid admissions. With the relaxing of wartime restrictions on travel, however, it is likely that the relative importance of spectator sports has increased. All other admissions accounted for 9.3 per cent of the 1945 total.

Exemption of Non-Profit Institutions

Under the Revenue Act of 1917, admissions to activities for the benefit of religious, educational, and charitable organizations, and to agricultural fairs were exempt. These exemptions were extended in later acts to include concerts conducted by civic membership associations, symphonic societies, etc., and performances for the benefit of the armed forces or other military reserve organizations, provided none of the earnings inured to the benefit of private individuals. In 1932, however, admissions to athletic games and exhibitions of colleges and universities, as well as to prize fights and similar activities of otherwise exempt institutions, were made subject to the tax.[9] The Revenue Act of 1941 finally terminated the exemption of all other institutions and thereby made the admissions tax universal in its application.

The exemption of non-profit institutions in the past raised serious problems of enforcement of the admissions tax. Many benefit performances were sponsored by charitable and other exempt organizations when most of the proceeds actually went to private promoters who supplied the entertainment. It was found virtually impossible in practice to restrict the privilege to *bona fide* exempt organizations and the Bureau of Internal Revenue naturally does not desire a return of these problems.

The elimination of exemptions by the Revenue Act of 1941, however, created a new problem of discrimination against religious, charitable, and other similar non-profit institutions. This arose because the purchaser of tickets to benefit performances is frequently expected to make a contribution which is incorporated in the price of admission. While it was admitted by the Treasury Department that the portion of the charge in excess of the established commercial price should not, in principle, be taxed, it was exceedingly difficult to accomplish this without subjecting the privilege to abuse. The Bureau of Internal Revenue finally sanctioned a method by which the "contribution" may be legally exempted by stating separately on a reservation blank the regular price and the contribution expected.[10]

[8] See statement of Ted R. Gamble, Chairman, American Theaters Association, before Committee on Ways and Means, *Hearings on Proposed Revision of the Internal Revenue Code, 1947-1948*, Part I, Excise Taxes, p. 700.

[9] *Revenue Act of 1932.*

[10] The technical requirements are as follows: (1) It is necessary to state specifically that the tickets may be obtained without making a contribution; (2) no indication should be made that the form of ticket was devised to meet the Bureau requirements; (3) supplementary literature would be subject to the same interpretation.

The constitutionality of the tax on admissions was challenged by state governments and agencies which were required to collect the tax on admissions to sporting and other events conducted by them. In 1938, the Supreme Court held that immunity from Federal taxes does not extend to business enterprises conducted by the state for gain.[11] The court held that, ". . . the conduct of exhibitions for admissions paid by the public is not such a function of state government as to be free from the burden of a non-discriminatory tax laid on all admissions to public exhibitions to which an admission fee is charged." This significant doctrine made it possible for the Federal Government to levy taxes on the proprietary activities of states and municipalities and their agencies on the same basis as a private business.

Tax Avoidance and Discrimination

Since the removal of exemptions by the Revenue Act of 1941, admissions taxes have covered virtually all commercial entertainment. Taxes on entertainment in cabarets and similar places and on club dues and initiation fees [12] help round out the field of close substitutes. Many borderline cases of avoidance have arisen where the applicability of the tax has been clarified only as the result of administrative and court decisions over a long period of time. A residue of situations still remains, however, where avoidance is alleged to exist. In addition there is a much larger area of competitive recreation and entertainment which either escapes taxation entirely or is taxed at preferential rates by the Federal Government.

The definition of what constitutes "admission to any place" [13] has caused the Bureau of Internal Revenue some difficulty. The law specifically includes charges for seats and tables and similar accommodations but does not specify whether the rental of certain facilities should be included or not.[14] Several court decisions have clarified the applicability of the tax to such charges if they include the right of admission.[15] If admission is allowed at a lower price to those who do not rent the equipment, this charge constitutes the tax base.[16]

The same rule applies to the use of transportation facilities. A toll charge on a private road leading to a resort was judged to be levied actually for the privilege of using the amusement park and not the road, [17] but a charge for transporting guests to an island where a private beach is maintained is a *bona fide* transportation expense and not an admission.[18] The distinction apparently hinges on whether access to the area in question can be gained without paying the toll. While the

[11] *Allen* v. *Regents of the University System of Georgia*, 304 U. S. 439. In this case the taxability of admissions to athletic events conducted by state universities was at stake.

[12] Dues, membership, and initiation fees paid to any social, athletic, or sporting club were first taxed by the Act of 1917. At the present time a tax of 20 per cent applies to such charges in excess of $10. Sec. 1710 as amended by Sec. 543 (a) of the *Revenue Act of 1941*. Total collections in the fiscal year 1947 amounted to $23.3 million.

[13] *Internal Revenue Code*, Sec. 1700(a) (1).

[14] *Internal Revenue Code*, Sec. 1704.

[15] *U. S.* v. *Koller, et al*, 287 Fed. 418 (W. D. Wash. 1921); appeal dismissed 260 U. S. 757; *Twin Falls Natatorium* v. *U. S.*, 22 Fed. (2d) 308, S. T. 859, 1937, 1 *Cum. Bull.* 334.

[16] Bureau of Internal Revenue, *Regulations 43*, p. 6.

[17] *Chimney Rock Co.* v. *U. S.*, *Cum. Bull.* VI-2, 303-304 (1927).

[18] *Huguenot Yacht Club* v. *U. S.*, 32 F. Supp. 387 (S. D. N. Y., 1940).

toll road represented an exclusive entrance to an amusement park, the boat ride did not.

The position taken by the Bureau of Internal Revenue with respect to the student activities fees has been less consistent. While the activities fee of a college student was not considered an admission charge,[19] a similar amount paid by high school students was held taxable.[20] This anomalous situation was finally remedied in 1945 by imposing the tax on all student fees representing amounts paid for admissions.[21] The charge applicable to admissions may be separated from that covering other activities, and taxed separately.

The tax on admissions cannot be easily avoided by calling the entrance charge a "contribution." In the case of a political meeting, free admittance could be gained to the place but the seats were allocated on the basis of the contribution made, ranging from $.50 to $2.00. The tax was, therefore, levied by the Bureau according to the contribution.[22]

Because of the restricted definition of admissions, charges for the use of public golf courses and tennis courts now escape taxation. Charges paid by a guest for the use of facilities of a private club are also non-taxable.[23] There appears to be no justification for this exclusion except the designation of these charges as fees for the use of the course or court. Since such fees are equivalent to an admissions charge to a swimming pool or ice skating rink, now taxable, the definition of admissions should probably be broadened to include "green" fees and tennis fees as well.

Many places of amusement and recreation are alleged to avoid the admissions tax by charging only for the use of facilities.[24] Among these places are "bingo" games, where a charge is made for cards; "taxi" dance halls, where a separate charge is made for each dance; and roller skating rinks, where there is a fee for the use of skates. The regulations are designed to prevent evasion of the tax where a charge for the use of facilities includes the right of admission. It is probable, therefore, that the law is being violated in the latter two instances, if not so clearly violated in the case of "bingo" games. Since "bingo" is in the nature of a lottery, conducted largely by religious and charitable institutions, its taxation would be difficult to justify.

Bowling alleys and pool parlors are now taxed by annual excises of $20 for each alley and pool table.[25] Since these services are in close competition with many types of recreation subject to the admissions tax, they should, in principle, carry an equivalent rate of tax in order to avoid discrimination. The preferential tax position of these places is indicated by the total revenue yield in the fiscal year 1947 of $4.5 million,[26]

19 S. T. 563 *Cum. Bull.* XI-2, 522.

20 "Tax on admissions to athletic games and other entertainment conducted by High Schools," B.I.R., Coll. No. 5289, November 22, 1941.

21 "Tax on admissions to athletic games and other affairs conducted by schools," B.I.R. Mim. 5843, March 21, 1945.

22 S. M. 2853, *Cum. Bull.* IV-1, 294 (1925).

23 B.I.R., *Regulations* 43, p. 25.

24 *Hearings, Revenue Act of 1941*, Committee on Ways and Means, p. 889.

25 *Internal Revenue Code*, Part X, Sec. 3268.

26 *Treasury Bulletin*, November, 1947, p. 54.

compared with a potential yield of at least four times this—$18 million—at a tax of 20 per cent on gross receipts.[27] Not only would replacement of the present flat excises by a gross receipts tax of 20 per cent achieve equalization with taxes on other places of entertainment, but it would better enable proprietors to shift the tax to patrons in the charges made for the use of facilities. One possible objection to the employment of a gross receipts tax is the problem of enforcement. Whereas pool tables and bowling alleys cannot be concealed, gross receipts may be easily hidden.

Enforcement Procedure

Administration of the admissions tax has presented few difficulties, according to the Bureau of Internal Revenue.[28] Its enforcement requires a detailed examination of the number of tickets sold, the daily performance for which sold, records of free or reduced admissions, number of unsold tickets for each performance, and refunds or credits claimed. Proprietors are required to keep records for all these items.

Control over the places of amusement is exercised by the requirement that all places subject to the tax secure a certificate of registry and post it conspicuously in the place of business. Reports are mailed monthly to these places, the names of which are, in some districts, kept in an addressograph file until a return marked "final" is filed.

Enforcement of the law is assisted by the requirement that the admission price and tax be printed separately on the tickets and that they either be serially numbered or show the date for which valid.[29] All ticket printers are expected to observe these regulations and to make reports to the district collector regarding the tickets printed. Such reports include the name of the customer, number of tickets printed, opening and closing serial numbers, and samples of the tickets.[30] While no penalty attaches to the printer for failure to observe these rules, the exhibitor may be held liable for their violation. According to the Bureau of Internal Revenue, the cooperation of the printers has been very satisfactory.

The law is enforced by the local collectors. In only one district, New York City, has a special field staff been maintained. This special force is occasioned principally by the existence of an unusual number of ticket brokers in the New York market. In other areas, spot checking is done by Treasury agents. Investigation is made of violations of the law both as a routine matter and on the basis of reports of evasion. In some districts the agents are required to collect a monthly quota of taxes which are delinquent or are being evaded.

Special investigations conducted in metropolitan areas are reported to have produced excellent results, both with respect to increased collections and in securing greater compliance with the

[27] Latest estimates of consumer expenditures in billiard parlors and bowling alleys are for the year 1945, and amounted to $92 million. *National Income,* supplement to *Survey of Current Business,* July, 1947, p. 43.

[28] "Reports of the Miscellaneous Tax Unit upon the History and Application of the Various Miscellaneous Taxes," 1936, p. 180.

[29] B.I.R., *Regulations 43,* p. 20.

[30] "Requirements regarding the printing of tickets," Mim. 5145, *Cum. Bull.* 1941-1, p. 457.

law.[31] A number of convictions were obtained for failure to collect or report the proper amount of tax or otherwise comply with the law. While it is claimed that evasion is not serious, it is questionable whether much detailed auditing or checking is practiced because of the limited personnel. In view of the results claimed for the field staff in New York City, further development of such staffs in other areas would appear to be necessary to enforce the law effectively.

Liability for the Tax

An unusual feature of the admissions tax is that it is levied directly on the consumer and required to be collected by the amusement operator. Failure to collect the tax by the latter therefore raises a nice question of law. Under the present law, the proprietor may be held liable only in case of "willful failure" to collect the tax, in which case the tax may be assessed in addition to a fine.[32] Because of the difficulty of proving that failure to collect the tax is deliberate it has been proposed to eliminate the word "willful." The principal objection to this change is that the word "willful" is strongly imbedded in the Internal Revenue Code, not only with respect to the admissions tax but other taxes as well.

Since the proposed change would be equivalent to holding the proprietor responsible for payment of the tax, whether collected or not, it would be preferable to hold him liable in fact rather than in name only. Instead of requiring the proprietor to be a collecting agent for the Government, the tax should probably be levied directly on him and shifted to the consumer. This practice would make the liability for the admissions tax consistent with the practice in levying the other major retail sales taxes on furs, jewelry, and toilet preparations. At the present time the only excises levied on the consumer are those on admissions, club dues and initiation fees, transportation of persons, and telephone charges. There is no problem of enforcement in the last two cases because of the relatively small number and large scale of the enterprises concerned. The liability for the cabaret tax was only recently transferred from the patron to the vendor,[33] and there appears to be no good reason why the same practice should not be adopted for the general admissions tax as well.

2. DISTRIBUTIONAL ASPECTS

Relationship to Income Class

No particular levy can be evaluated in a vacuum, but the prejudices of the taxpayer may be better satisfied by some excises than by others, depending on the popular conception of whether they bear more or less upon the necessities of life. In this respect entertainment appears to find a rather high place in the hierarchy of "non-essentials," albeit not one of those commodities "which poor people ought to do without and won't." [34] This view is fairly well supported by the moderately progressive relationship of expenditures on admissions to the size of income, within limits, as shown in Table 4. (If expenditures

[31] *Report of the Commissioner of Internal Revenue*, 1941, p. 29.

[32] *Internal Revenue Code*, Sec. 1718.

[33] *Revenue Act of 1941*, Sec. 542.

[34] Henry C. Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938), p. 41.

on that more conspicuous element of consumption manifested in cabarets were included, the degree of progession would undoubtedly be enhanced.)

Analysis of urban family and individual expenditures in 1941 shows that average paid admissions increased as a percentage of income from about 1.2 per cent for the lowest income class to about 1.6 per cent of the $3,000-$5,000 income class, and thereafter declined with an increase in income.[35] The relative importance of movie entertainment to lower income groups is clearly shown by the fact that other types of admissions, while considerably less in the aggregate, tended to equal movie admissions for those with incomes in excess of $10,000. It may be concluded from these data that the admissions tax is roughly progressive up to the $4,000-$5,000 income level, where it becomes regressive.

The admissions tax may thus be defended on equitable principles as an integral part of a tax system which relies heavily on the income tax for its main support.[36] While perhaps not well articulated with the personal income tax, it provides a progressive element of taxation within that area not reached by direct taxes. The operation of the graduated income tax may, in fact, be one of the important factors (together with increased rate of saving) limiting the progressive relationship of admissions to size of income.

TABLE 4

AVERAGE EXPENDITURES ON PAID ADMISSIONS BY MONEY INCOME CLASS, URBAN FAMILIES AND SINGLE CONSUMERS: 1941

Income Class	Average Family Expenditure			Per Cent of Income		
	Movies	Other	Total	Movies	Other	Total
Under $ 500	$ 3.31	$ .33	$ 3.64	1.07	.11	1.17
$ 500- 1,000	7.15	1.34	8.49	0.97	.18	1.15
1,000- 1,500	14.00	2.23	16.23	1.12	.18	1.30
1,500- 2,000	20.68	3.36	24.04	1.18	.19	1.37
2,000- 2,500	24.88	5.60	30.48	1.11	.25	1.36
2,500- 3,000	36.71	5.05	41.76	1.34	.18	1.52
3,000- 5,000	49.52	11.79	61.31	1.32	.32	1.64
5,000- 10,000	57.02	25.80	82.82	0.92	.41	1.33
Over 10,000	71.23	66.84	138.07	.50	.47	0.97

Source: *Family Spending and Saving in Wartime,* U. S. Department of Labor, Bureau of Labor Statistics, Bulletin No. 822 (1945), pp. 102, 184.

Coverage

The admissions tax is fairly comprehensive in its coverage. Estimates for 1934-1936 disclose that about 80 per cent of all families attended movies at least once a year, but that attendance

[35] Earlier data for the period 1935-1936, which included both urban and farm expenditures, showed a similar relationship but at a lower percentage of income for all income classes, which tended to level off at about 1.2 per cent for groups between $1,500 and $5,000 income. Disparity with the later study can probably be accounted for by the inclusion of farm families and of non-cash income. National Resources Planning Board, *Family Expenditures in the United States, Statistical Tables and Appendices* (1941), p. 43.

[36] In the fiscal year 1947, admissions taxes amounted to 1.0 per cent of total Federal tax collections and income taxes to 72.8 per cent. *Treasury Bulletin,* December, 1947, pp. 50, 53.

varied from 65 per cent of the lowest income group to 94 per cent for those with incomes above $10,000.[37] Spectator sports were appreciably less popular, with the percentage of families attending ranging from 10.6 per cent to 34.0 per cent.[38] Data for 1941 show that admissions by urban families to all entertainment other than movies increased from 5.1 per cent to 82.4 per cent for the largest income class studied.[39] It is impossible to determine from reported data how exclusive the above estimates of attendance are in the different categories. Nevertheless, it appears that the various forms of commercial entertainment for which admissions are paid are fairly universal in their enjoyment, and that their taxation secures some contribution to public revenues from perhaps 85 to 90 per cent of income units—families and individuals.

3. INCIDENCE AND EFFECTS

The probable incidence of a tax on admissions is governed by many factors peculiar to the nature of the product, the structure of the amusement industry, and the levy itself. The fact that the impact of the tax is legally on the patron and collected as a separate charge is conducive to its shifting but, of course, does not preclude absorption by the industry of at least part of the tax through price adjustments. This, in theory, appears to be the case, in the short run, if not in the long run. Unfortunately, limitations of published data, particularly price series, do not permit any inductive verification of the theoretical conclusions. The following deductive analysis will be limited to the movie industry, for which most information is available, and which accounts for the preponderant portion of all admissions.

Each film is a unique product, the basis of whose appeal is a combination of monopolized talent and ingenious script, more or less artfully directed and produced. Differentiation is further enhanced by the fullest development of all the known techniques of publicity and advertising. In addition, the film is leased for exhibition in an exclusive market, at discriminatory prices and terms which are calculated to produce maximum profits.

The industry is dominated by a few major producers who account for virtually all important feature pictures. The retail market, at the other end, is characterized by a small number of outlets in each city or town, segregated to some extent into first run downtown and second run neighborhood houses. The most important of these, estimated to account for 59 per cent of box office receipts in 1939,[40] are owned or controlled by five large integrated companies. Considerable territorial divison of the market is evidenced in this ownership.[41]

The integrated companies, by reason of their control of production and strategic location of outlets in metropolitan areas and large cities, are in a

[37] *Money Disbursements of Wage Earners and Clerical Workers*, Bureau of Labor Statistics, Bulletin No. 638, Table A-10.

[38] *Ibid.*

[39] B.L.S. Bulletin No. 822, *op. cit.*, p. 184.

[40] *International Motion Picture Almanac*, 1941. Other estimates place the concentration as high as 70 per cent.

[41] *The Motion Picture Industry—A Pattern of Control*. T.N.E.C. Monograph No. 43 (Washington, D.C., 1941), pp. 9-15.

position to dictate the price policy (and profits) of independent exhibitors. This control has been perfected by all producers through a variety of techniques, whether incorporated in the film rental contract or not. Rental charges are based on a fixed fee or percentage of gross, or both. For most Class A pictures, these charges are determined on the basis of box office appeal as evidenced by advance showings. Since the difference between the success and failure of a picture is ordinarily dependent upon the revenue from second-run exhibitions, the price differential, length of run, and "clearance," i. e., the time elapsing between two runs, are carefully adjusted to yield the maximum revenue. Because of the nature of this control, independents are considerably circumscribed not only in their pricing policies but also in the quality of their offerings, for which they contract in advance by "block-booking," i. e., by taking blocks of pictures in the selection of which there is frequently little choice.[42]

The pricing of admissions is thus conducted under a set of conditions which can best be described as one of monopolistic competition supplemented by substantial elements of oligopoly.[43] As a result, the industry has been able to realize appreciable excess profits through its pricing policy. The imposition of a sales tax under these circumstances is likely to result in the immediate increase in the cost of admissions by the amount of the tax. Within the short run period, however, a downward adjustment of prices (*ex* tax) is likely if the industry was previously realizing its maximum profit. The extent of price readjustment would depend, of course, on the degree of uniformity in pricing among members of the industry, the character of costs, as well as the elasticity of demand for entertainment in general and the extent of decline in attendance experienced by each firm. In theory, then, prices (including tax) would tend to be raised in the short run by an amount less than the tax.[44]

This result would be reinforced by two other factors peculiar to the admissions tax: the fact that it is an ad valorem rather than a specific levy and that it discriminates against one particular class of consumer expenditures rather than applying uniformly to all expenditures as in the case of a general sales tax. The amount of price increase occasioned by an ad valorem levy

[42] These conditions remain virtually unchanged despite a consent decree entered in 1940 for the elimination of various monopolistic practices. *U.S. v. Paramount Pictures, Inc., et al.*, Civil Action No. 87-273, in the District Court of the U. S. for the Southern District of New York, November 14, 1940. This decree was revoked December 31, 1946, and a new decree entered dismissing all complaints based on acts as *producers*. In April, 1947, a stay was granted (which holds until final determination by the Supreme Court) with respect to minimum price fixing, "clearance" system, competitive bidding, block-booking, and arbitration system. According to one authority, this stay had the effect of reverting to the *status quo ante* September, 1940. Robert A. Brady, "The Problem of Monopoly in the Motion Picture Industry," *Annals*, American Academy of Political and Social Science, November, 1947, p. 135.

[43] See John F. Due, *The Theory of Incidence of Sales Taxation* (New York: King's Crown Press, 1942), pp. 9-10.

[44] *Ibid.*, pp. 61-63. Testimony of theater owners before the Committee on Ways and Means emphasized the sensitivity of attendance to price changes and the likelihood that the admissions tax is absorbed. While undoubtedly exaggerated there is probably an element of truth in the claim. *Hearings*, Part I, Excise Taxes, May 29, 1947, p. 215.

is generally agreed to be less than that of an equivalent specific tax.[45] Tax discrimination against particular commodities also tends to inhibit price changes because of the diversion of demand to other non-taxed products.

Since the shifting of the tax, whether fully or partially, can be accomplished only by a reduction in theater attendance (assuming no shifts in demand) excess profits would be reduced in the short run and many firms would probably leave the industry. In view of the relative fixity of exhibition costs, most of the burden of the reduced volume would probably be borne by the exhibitor.[46] The possibility remains, however, of part, at least, of this loss being absorbed by the producer in lower film rentals. Reductions may also be made through production economies, quality changes, and curtailment of special features.

With the exit of movie outlets over a period of time (or with a long run shift in demand) a new equilibrium will be established by the movie industry at a point where capacity is adjusted to demand at a price sufficient to recover previous monopolistic profits. In the long run, then, the industry would probably shift the entire amount of tax forward in higher prices.[47] The new level of prices would be higher by an amount equal to the tax if constant cost conditions are found in the industry.

The short-run implications of a reduction in admissions taxes under present conditions may be inferred from the above analysis. If the capacity of the industry is in equilibrium with demand at existing prices, any reduction of the tax rate would tend to be accompanied by an equivalent increase in admission prices. Loss in tax revenue would thus tend to be converted into higher profits by the amusement industry in the short run. Because of their monopolistic control over the exhibitor it is likely that these windfall profits would be recaptured by the producers through higher film rental charges.

4. STATE ADMISSIONS TAXES

Taxes on General Admissions

Connecticut was the first state to tax general admissions, with its levy of 1921, which was shared with the counties.[48] This was a supplementary rate equal to one-half the Federal tax liability. With the increase in Federal price exemptions of the 1920's, revenues virtually disappeared and the tax was repealed as of July 1, 1929.[49] The license tax based on seating capacity, enacted in 1927, was continued, however, and is still in effect. South Carolina introduced a tax on admissions in 1923 and Mississippi in 1930. Although both excises are still in effect, South Carolina has since exempted moving picture theaters, which are now subject to a tax on seating capacity.

[45] Due, *op. cit.*, pp. 94-95; Albert L. Meyers, *Modern Economic Problems* (New York: Prentice-Hall, Inc., 1941), p. 43.

[46] Committee on Ways and Means, *Hearings, op. cit.*, p. 206. The percentage allocation of film exhibition income is estimated as follows: film rental, 35 per cent; real estate, 20; payroll, 16; advertising and publicity, 8; electricity and heat, 8; other taxes and insurance, 4; extra attractions, 3; interest and profits, 6. Estimated by *Film Facts*, 1942.

[47] Due, *op. cit.*, pp. 76-82.

[48] R. B. Tower, *Luxury Taxation and Its Place in a System of Public Revenues* (Albany: Tax Commission of the State of New York, 1931), p. 63.

[49] *Ibid.*

By the end of 1947, all but eight states[50] and the District of Columbia had taxes on admissions of one category or another. Of these, twenty-three states levied uniform taxes on admissions to entertainment in general, supplemented in nine cases by special excises on admissions to either racing meets or boxing matches or both. As can be seen in Table 5, most of the rates are rather modest. The gross receipts taxes of Maryland, Indiana, and Montana are negligible. The most frequent rate is 2 per cent, employed by thirteen states; two states now have a rate of 3 per cent, and one, Louisiana, an annual gross receipts tax which approximates 5 per cent. In only four states does the tax rate appear to be high enough to raise a serious problem of duplication of the Federal tax, and in each of these cases the real rate is mitigated somewhat by special exceptions: Kentucky provides an exclusion for the first 10 cents of admission; Mississippi has a preferential rate for admissions under 25 cents; South Carolina exempts moving picture theaters which pay an annual license tax on seating capacity; and Texas exempts general admissions under 51 cents.

In about one-half the states, exemption is provided for entertainment of non-profit organizations (with some qualifications); about one-third of the states exempt admissions to fairs. Price exemptions for admissions under certain amounts are also provided, probably for the most part under the bracket system of state sales taxes. In only one state, Texas, is any substantial price exemption given—51 cents. An exclusion of the first 10 cents is a distinctive feature of the Kentucky tax.

TABLE 5

State Taxes on General Admissions

Rate	State
0.5 per cent	Maryland
1 per cent	Indiana[a]
1.25 per cent	Montana[b]
2 per cent	Alabama, Arizona,[a] Arkansas, Iowa, Kansas, Missouri, New Mexico,[a] North Dakota, Oklahoma, South Dakota, Utah, West Virginia,[a] Wyoming.
3 per cent	North Carolina,[c] Tennessee
5 per cent	Louisiana[d]
1 cent for each 10 cents	Kentucky,[e] Mississippi,[f] South Carolina,[c] Texas[g]

Source: Commerce Clearing House, *Corporation Tax Service; Tax Systems of the World, 1947*.

[a] Levied under gross receipts tax.

[b] In excess of $3,000 gross receipts each quarter.

[c] Moving picture theaters exempt from admissions tax but taxed separately by excise based on seating capacity.

[d] Annual license tax, based on gross receipts, which approximates 5 per cent.

[e] First 10 cents of admissions up to $1.00 excluded from tax; $1.01 and over—10 cents plus 1 cent for each 25 cents.

[f] One-half cent for each 10 cents under 25 cents.

[g] Applies only to admissions in excess of 51 cents, except racing.

It is a curious fact that many of the general sales tax states have neglected to bring entertainment within the system. While the omission largely arises from the conventional definition of sales to include only transfer of title to tangible goods, it would be easy to include admissions as well, as many other states have done. Nevertheless, Colorado, Connecticut, Michigan, California, Illinois, Rhode Island, and Washington,

[50] Colorado, Connecticut, Georgia, Nevada, New Hampshire, Oregon, Vermont, Virginia. Two of these, Connecticut and Virginia, impose license taxes based on seating capacity.

and now Ohio, have no corresponding general tax on admissions. Several of these states impose license taxes on certain amusements or special gross receipts taxes on boxing or racing and others have withdrawn from the field in favor of local governments.[51] North Carolina eliminated the 3 per cent tax on admissions to shows in 1943. While this was accompanied by an increase in the license tax based on seating capacity, the revenues were reduced more than 60 per cent.

Excises on Boxing, Wrestling, and Racing

Horse racing, boxing, and wrestling have long been a favorite object of taxation. Not only do many states without general admissions taxes exact a tribute from these spectator sports, but nine of the states described above single out at least one of these sports for special rates. Either because of moralistic distinctions or because these sports are regarded as evidences of conspicuous consumption, less restraint has been shown in their taxation than in the case of more conventional amusements. The result has been the imposition of rates appreciably higher than admissions taxes generally—so that Federal-state duplication is more prominent (although not necessarily more serious) in this area than elsewhere.

Admissions to horse racing are taxed at the following rates in the twelve states specially taxing such admissions:[52]

10 per cent—Arkansas,[53] Idaho, New Jersey, New Mexico, Texas;

15 per cent—Florida, New York;

10 cents per admission—Louisiana;

15 cents per admission — Kentucky, Nebraska;

20 cents per admission — Delaware, Illinois.

While boxing, sparring, and wrestling matches are taxed by more states (twenty-one) than racing (twelve) the typical tax is 5 per cent of gross receipts compared with 10 per cent for the latter. Rates on boxing and wrestling admissions are summarized as follows: [54]

3 per cent—Maine, Texas;

5 per cent — Delaware, Kentucky, Louisiana, Massachusetts, Nebraska, New York, North Dakota, Pennsylvania, Washington, West Virginia, Wisconsin;

10 per cent—California, Idaho, Illinois, Indiana, Michigan, Minnesota, New Jersey, South Dakota.

In addition to the above taxes levied either on admissions or gross receipts, these sports events are typically subject to special flat or graduated license taxes. However, the revenues derived from both these sources pale into insignificance when compared with the tribute from the pari-mutuel betting, both on the total handle and from the breakage.

Revenues

It is not possible from available data to give more than a rough estimate of total receipts from state taxes on admissions. They are completely segregated neither from other taxes on amusements, nor from general sales taxes where they form a part of these levies. Nevertheless, the total of state

51 See *infra.*

52 Commerce Clearing House, *Corporation Tax Service; Tax Systems of the World.*

53 Or 10 cents whichever higher.

54 Commerce Clearing House, *Corporation Tax Service; Tax Systems of the World.*

revenues reported from all admissions in the fiscal period 1947 indicates little duplication with the Federal levy. All together, general and special admissions taxes yielded a minimum of $11.2 million of which the major part segregated, $7.2 million, was derived from general admissions taxes.[55]

5. LOCAL ADMISSIONS TAXES

The most significant recent development of taxes on amusements is found in local government. Many municipalities have recently looked to the admissions tax as an important means of supplementing the property tax, which has proved inadequate to meet the rapidly rising post-war costs of government. While less substantial in yield than taxes on gross incomes or retail sales, the admissions tax nevertheless provides a much needed source of diversification in revenue. The more important cities imposing taxes on admissions, and their rates, are listed in Table 6. Many other smaller communities have also adopted admissions taxes, and others are seriously considering this step.

Philadelphia appears to have ventured first in this field with its admissions tax of 1 cent on each 25 cents in 1937.[56] This was raised to 1 cent for each 10 cents in 1946. Charleston, West Virginia, introduced a tax of 1 cent on each admission in 1938.[57] It was not until 1942 and 1943 that cities in the states of California, Alabama, and Washington began a widespread adoption of this tax at various rates, either ad valorem or flat amounts for each ticket. Adoptions accelerated in 1946 and 1947, particularly by large cities such as Pittsburgh, Chicago, Cleveland, St. Paul, Richmond, and Norfolk, at rates ranging from 3 per cent to 1 cent for each 10 cents.

TABLE 6

CITY TAXES ON GENERAL ADMISSIONS[a]

Rate[b]	City
10 per cent	Alabama: Mobile, Gadsen, others; Pennsylvania: Philadelphia, Pittsburg; Virginia: Norfolk, Petersburg.
5 per cent	St. Paul, Minnesota; Richmond, Virginia; Washington: Seattle, Spokane, Everett, Bellingham, others.
3 per cent	Chicago, Illinois; Atlantic City, New Jersey; Cleveland, Ohio.
2 per cent	Georgia: Augusta, Savannah; Hannibal, Missouri; Clarksburg, West Virginia.
3 cents	San Bernardino, California.
2 cents	Stockton, California.
1 cent	California: San Diego, Bakersfield; Charleston, West Virginia.

Sources: A. M. Hillhouse and Muriel Magelsson, *Where Cities Get Their Money* (Chicago, 1945); A. M. Hillhouse, *1947 Supplement;* Municipal Finance Officers Association, correspondence.

[a] In addition, Kansas City, Missouri, levies a tax of 5 per cent on admissions with the exception of theaters, and St. Louis, Missouri, taxes sports at 3 per cent.

[b] Approximate percentage rate where levied at 1 cent for each 10 cents or each 20 cents, etc.

6. INTERGOVERNMENTAL COORDINATION

State-Local Relations

The taxing authority of municipalities is derived from the state. It is significant that, with few exceptions, municipal admissions taxes are found

[55] Derived from *Sources of State Tax Revenue in 1947*, U. S. Bureau of the Census, November, 1947. Of this amount $3.0 million was reported by Ohio, $1.5 million by New York, $1.6 million by Kentucky, and $0.9 million by Mississippi.

[56] A. M. Hillhouse and Muriel Magelsson, *Where Cities Get Their Money* (Chicago, 1945), p. 10.

[57] *Ibid.*

in states that have relinquished this field to local governments. Duplication has thus been virtually eliminated except with respect to boxing and racing. In Alabama, Missouri, and West Virginia, the state rate is only 2 per cent, and over-lapping is not serious. California, Virginia, and New Jersey have never employed admissions taxes except on boxing or racing receipts. The Illinois legislature rejected a 5 per cent tax on general admissions in 1947, and the New York State legislature has only recently (1947) authorized its counties and New York City to impose taxes not in excess of 5 per cent on admissions to theaters and other places of amusement, with the exception of boxing, wrestling, and race tracks which are taxed by the State. According to the American Municipal Association, four other state legislatures meeting in 1947—New Jersey, Maryland, Pennsylvania, and Virginia—permitted all or some cities to levy local admissions taxes.[58]

Several other states have withdrawn from the general admissions tax field in favor of local governments. Pennsylvania abandoned its tax in 1937, thus enabling Philadelphia, and more recently, Pittsburgh, to exploit this revenue. Washington surrendered the admissions tax to local governments in 1943, and as a result virtually every city in the State with over 10,000 population has adopted it. Ohio has just relinquished its amusement tax (1947) and it can be expected that other municipalities will follow Cleveland in this field. While the State of North Carolina removed theater admissions from the general sales tax in 1943, local governments are not authorized to employ this tax source.

Federal and State-Local Overlapping

The recent invasion of the amusement tax field by municipalities has pointed up an important new area of duplication with a tax long preempted by the Federal Government. Existing taxes on general admissions amount to about 32 per cent in many instances and even higher on certain spectator sports. No categorical answer can be given to the question of whether existing taxes unfairly discriminate against this class of consumption. Compared with rates on bowling alleys, pool parlors, club dues and initiation fees, as well as cabarets, where there is no extensive overlapping, admissions excises appear to be high. It is significant, moreover, that the Congress reduced the cabaret tax from 30 per cent to 20 per cent after a short trial during the war when a higher tax on non-essential expenditures could be even better justified.

The fact remains that a Federal admissions tax of 20 per cent is the major obstacle to the full utilization of this vital revenue source by local governments. While a Federal rate of 20 per cent does not preclude other levels of government from entering this field at fairly high rates (evidenced by the employment of 10 per cent excises by many communities and several states), the adoption of adequate rates by many cities has been effectively blocked by the plea that the Federal excise is already too high.[59]

[58] *National Municipal Review*, November, 1947, p. 596.

[59] Miami voters rejected a new admissions tax. *Newsweek*, December 7, 1946. The 10 per cent tax of Pittsburg was finally adopted against the organized opposition of the entertainment interests and apparently considerable popular resentment. *New York Times*, November 23, 1947. Other cities have turned down proposed levies on admissions.

Adaptability to Local Needs

If the present high rate of Federal taxation does indeed militate against the adoption of admissions taxes by local governments, it remains to consider the claims of the municipalities (and states) to this source of revenue. While the Federal Government has priority in time, the appropriate place of an amusement tax should properly be considered as part of a general program for tax coordination between the different levels of government, which is based on general principles rather than priority or *ad hoc* bargaining. Pending the development of a rational program, which is already long overdue, it is important to weigh the respective claims of the Federal and state governments to taxes on amusements and to work out some early solution to the immediate problem of tax-overlapping, which is of such vital concern to local government.

If based upon *need*, it can be fairly conclusively argued that new revenue requirements of local governments are the most pressing of all. The Federal Government has actually undertaken substantial tax reductions and further cuts are in prospect. Because of their larger size, state revenue systems are more diversified and expansive than those of local governments. As pointed out in a recent report, " . . . the states have diversified their revenue systems and (between 1926 and 1942) increased their tax yields thirteen times as rapidly as localities." [60] Localities, on the other hand, have entered upon a new phase of financial distress which has made them increasingly dependent upon state aid. The antiquated property tax has been stretched to its legal and economic limits, and other revenue sources have been restricted by the states. If the localities are to maintain substantial financial independence, suitable sources of revenue must be made available to them. It is believed that, among other excises, admissions taxes are admirably adapted to their requirements.

Admissions taxes meet the test of *stability* fairly well. Expenditures on amusement are a fairly constant proportion of consumer expenditures—during the period 1934-1946 the ratio ranged between 1.20 and 1.30 per cent.[61] Because of the relative stability of consumption taxes, compared with taxes on net income and other revenues, it would be consistent with a countercyclical fiscal policy urged on the Federal Government to relinquish consumption taxes to the states and localities, which need a steady source of revenue.

With respect to *adequacy*, however, the potentialities of taxes on amusements should not be over-emphasized. While vital to many localities, at present rates they make only a modest contribution to municipal treasuries. Even at the current maximum of 10 per cent, for example, the city of Norfolk, Virginia, realized no more than 4.1 per cent of its total general revenue receipts from this source in 1946.[62] The yield appears to vary somewhat with the size of the city. While the average tax per capita for the country as a whole was about $1.25 in 1946 (for each 10 per cent rate), the typical yield for

[60] *State-Local Relations*, Report of the Committee on State-Local Relations, Council of State Governments, 1946, p. 71.

[61] Computed on the basis of data reported in the *National Income*, supplement to the *Survey of Current Business*, July, 1947, Tables 3 and 30.

[62] *Proposed Current Budget for the Fiscal Year 1947*.

medium-sized cities at 1946 levels of income was about $2.40. Smaller cities and towns realized somewhat less.[63] This variation may be explained, of course, by the concentration of high incomes in urban areas and appreciably higher admission prices for theaters, concerts, etc.

Perhaps the best claim of state and local governments to the admissions tax can be made on *administrative* grounds. While Federal administration has presented few problems, the taxation of amusements appears to be especially well adapted to local conditions. This arises from the fact that the thing taxed is a peculiarly local service rather than a tangible commodity with some degree of mobility. There are no jurisdictional or interstate commerce problems, and the tax cannot be easily avoided. Municipalities may assess entertainment within their limits with little fear of "driving business out of town," which may deter use of a general sales tax. The most important marginal factor would be the cost of transportation beyond jurisdictional limits. Some inducement might be given to "drive-in" theaters and the location of new stadia outside of town but such loss would probably be negligible.

Cost of administration is unusually low. Collections may usually be handled with little or no additional personnel or other expense except for printing and stationary.[64] Seattle, for example, reports a cost of slightly less than 1 per cent. It is acknowledged that this low cost is made possible by the records required in payment of the Federal tax, which eliminate more than occasional auditing or checking.[65] If the Federal Government were to withdraw, cost of administration would probably increase appreciably.

Proposed Methods of Coordination

The various alternatives available for better coordination of admissions taxes between the different levels of government are described below.

Reduction of the Federal rate.—Repeal of the wartime increase in rates would enable municipalities (or states) to recapture the rate relinquished without undue difficulty. However, since substitution of local rates would probably be only partial and sporadic, the variable situation existing among different cities (and states) would create pressure against adoption of an equivalent rate by needy communities. The moving picture industry has recommended restoration of the pre-war rate (with the hope of its eventual abolition) but has either ignored the local incursion into this field or feels competent to deal with it as each situation arises.[66]

Complete segregation. — Immediate withdrawal of the Federal Government from the taxation of amusements would be inadvisable. While the way would be cleared for local adoption, with a minimum of resistance, it would be a gratuitous sacrifice of revenue if many communities failed to replace the tax with an equivalent rate. Since the capacity of the amusement industry is adjusted to the present level of taxation,

[63] Based on 1940 census data and estimates of revenue reported in Hillhouse, *op. cit.*, pp. 4, 26, and from budget sources.

[64] Hillhouse and Magelsson, *op. cit.*, p. 196.

[65] *Ibid.*, p. 200.

[66] Committee on Ways and Means, *Hearings*, *op. cit.*, p. 701.

outright repeal of the Federal tax would undoubtedly lead to short-run price increases and substantial windfall gains to producers and exhibitors. Much may be said for eventual relinquishment of the general admissions tax to states and local governments, but this should be accomplished gradually and coordinately with their development of this levy.

Federal sharing with states or local governments.—A rather interesting proposal has been made for the Federal Government to continue collection of the admissions tax but to share the revenues with local governments.[67] This plan would have the advantage of maintaining uniformity of rates through the country at the Federal level and would circumvent opposition to the introduction of local rates. The present rate could be shared 50-50 or a reduced rate could be collected by the Federal Government on behalf of the community, which would pay administration costs.

Although the proposal may be attractive at first sight, there appears to be little justification for the institution of a system of sharing of revenues in a field where interstate problems are negligible and the advantage of centralized administration unimportant.[68] Nor does it appear to be a suitable form of compensation for the services rendered Federal property in local areas, for which no property taxes or *in lieu* payments are made, as originally proposed.[69]

Local revenues from admissions would be greatly enhanced but the amount of tax shared would not be correlated with local need, would be a windfall in many cases, and might lead to extravagance in spending. Moreover, such an arrangement might create administrative complications and friction in the allocation of revenues. It would still leave the Federal Government in control of the tax—an outcome with which many state and local officials would not be sympathetic.

Federal price exemptions.—One of the more attractive proposals would be the restoration of Federal price exemptions, of, say 40 or 50 cents, with admissions below this amount reserved exclusively to the states and localities. This plan would leave the taxation of the vast proportion of conventional entertainment to local governments[70] and would thus produce a greater stability in local yield. The Federal Government could continue to tax the "luxury" class of entertainment at the full rate on all prices above the exemption, in accordance with pre-1940 practice. One possible objection to this proposal is the creation of a sharp differential below and above the exemption price (particularly at a Federal rate of 20 per cent) which may seriously limit flexibility in pricing.[71] Moreover, such ex-

[67] William Anderson, "Allocation of the Admissions Tax to Cities and Villages," *Minnesota Municipalities*, June, 1945, pp. 219-221.

[68] Sharing was proposed by the Committee on Intergovernmental Fiscal Relations as a solution to overlapping in the collection of tobacco taxes, but administrative effectiveness would undoubtedly be improved in this case. *Federal, State, and Local Government Fiscal Relations* (U.S. Senate Document No. 69, 78th Cong., 1st Sess., 1943), p. 16.

[69] Anderson, *op. cit.* p. 219.

[70] Average movie prices in 1947 were estimated at about 34 cents *ex* tax. *Hearings*, Committee on Ways and Means, *op. cit.*, p. 206.

[71] It is interesting to note that the moving picture industry in its first testimony before the committee on Ways and Means called for a graduated tax, i.e., price exemptions, but on later consideration proposed simply a reduction in the Federal rate to 1 cent for each 10 cents. *Ibid.*, pp. 208, 700.

emption would discriminate against opera, concerts, and the legitimate theater, for which prices ordinarily range higher than those of movies. This plan is also subject to the objections against a sudden removal or reduction of the admissions tax which would result in windfall profits to the amusement industry until replaced by local rates. Apparently the moving picture industry would benefit most from this situation.

The Outlook for Federal Coordination

The weight of informed opinion seems to favor Federal withdrawal from the admissions tax in favor of state and local governments. The problem of overlapping had not reached serious proportions when studied by the Treasury Committee on Intergovernmental Fiscal Relations in 1942, and no particular recommendations were made for its elimination.[72] More recently, however, the conflict had become sufficiently significant for an authoritative report on tax coordination to urge "that this field be left exclusively to the states."[73]

A recent joint conference of representatives of the Congress of the United States and the Governors Conference recommended that special consideration be given by the Federal Government to the reduction of certain excises, including the admissions tax, to permit their employment by state and local governments.[74] This recommendation was supported by the conformity of these excises to the following principles of adaptability to state and local use: (1) wide and uniform distribution through the states, (2) capability of withstanding interstate and interlocal differences in tax rates with a minimum of reduction in yield and economic repercussions, and (3) effectiveness and economy of administration at state and local level.[75]

However, little encouragement is given to the elimination of overlapping amusement taxes by a recent report of the Treasury Department. This study concluded: "All factors considered, there are no compelling reasons for an immediate coordination effort in the field of amusment taxation;" and "Amusement taxation can at best merit a low priority in a near-term program for Federal-state fiscal coordination."[76] It is true that administration of the admissions tax is singularly free of interstate problems that would justify immediate coordination. However, this official view does not indicate sufficient appreciation of the urgency of permitting fuller utilization by the municipalities (and states) of a revenue source that is conceded to be well adapted to local administration.

72 *Op. cit.*, p. 545.

73 *The Coordination of Federal, State and Local Taxation*, Report of the Joint Committee of the American Bar Association, National Tax Association, and the National Association of Tax Administrators, 1948, p. 102.

74 *State Government*, Council of State Governments, November, 1947, p. 299.

75 *Ibid*, p. 288.

76 *Federal-State Tax Coordination*, Division of Tax Research, August 4, 1947, p. 28.

AN INCENTIVE TAX PROPOSAL FOR ALLEVIATION OF THE HOUSING SHORTAGE

JEAN BRONFENBRENNER *

THE housing problem which has existed in this country, particularly since the end of World War II, has been discussed widely and needs no description here. Despite the wealth of discussion, however, no adequate steps have been taken toward a solution of the problem; it seems entirely possible that the shortage may persist for five years or even longer. Perhaps this is because distress has been concentrated within a relatively small group who have been forced to enter the housing market within the last two or three years. The great majority of families who were already housed adequately when the period of acute shortage began, not only have avoided the weary and frustrating search for a place to live and the difficulties of crowded, unsatisfactory accommodations, but also have been insulated under rent control from any bidding up of the price of their housing by those less fortunate than themselves.[1]

Professors Friedman and Stigler[2] have put very clearly the case against the present system of rent control without allocation of housing space:

(1) The relatively low price of housing[3] leads to the "hoarding" of housing space. In other words, it leads families to occupy larger dwelling units than they would demand normally. (Friedman and Stigler believe that this factor may itself explain the entire apparent shortage.)

(2) The burden of the shortage falls almost exclusively on those who find themselves currently in the market for housing. This group includes very largely returning veterans and their families.

(3) Many who prefer to rent are forced to buy at greatly inflated prices because rental property is not available. (It is very possible that these people may suffer a much greater financial loss than if they paid rent for a number of years at the levels probable in an uncontrolled market.)

Effects of Removing Rent Ceilings

There are several alternatives to the present unfortunate situation. Professors Friedman and Stigler, among others, suggest the removal of rent controls in favor of a return to the price rationing of the free market. They anticipate that this would bring about a more economical use of existing housing space and eventually lower the inflated selling prices for new and existing houses. Important objections, however, must be raised against this solution.

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[1] The principal exceptions to this generalization are persons who, in order to retain the use of the houses or apartments previously rented, have been forced to buy them at inflated prices.

[2] Milton Friedman and George J. Stigler, *Roofs or Ceilings?* (Irvington-on-Hudson, N. Y.: Foundation for Economic Education, 1946).

[3] Rents have risen substantially less during the war years than either incomes or most other cost-of-living items, creating an abnormal set of price relationships.

The removal of rent ceilings from new construction was undoubtedly correct and probably necessary. The ultimate solution of the housing shortage must come through new construction, and returns must be permitted to rise sufficiently to justify this construction at the prospective level of building costs.

The present writer is not impressed by the argument that higher rents on new housing must be accompanied by higher rents on old in order to assure "equal treatment for all."[4] If one wishes to argue in terms of equity, the owner of new housing is in a different position from existing landlords by reason of his higher costs of production. If one argues merely in terms of the efficient working of the economic system, it is necessary to pay factors of production whatever may be required to persuade them to perform their services. This amount is higher for those providing new housing than for owners of existing rental property.[5]

But clearly the solution of the problem via an increase in the supply of housing is a long-run one, since the yearly production of the existing labor force in the building trades is small relative to the need for housing. For the immediate future, the only hope lies in the redistribution of the existing housing facilities. General rent decontrol would indeed make it more expensive to "hoard" housing space. It would therefore permit the well-to-do—rather than the merely lucky—to hold excessive amounts of housing.[6] We would exchange a situation in which people live in crowded, undesirable quarters because they happen to need a house or apartment at the wrong time (and lack the proper connections or contacts) for one in which people live in such quarters because they cannot afford anything better.

It is true that there would be some gains from the exchange. Among other things, it seems to be psychologically more acceptable *in our society* to do without adequate housing because one cannot afford it than because one cannot find it. Furthermore, to a large extent, the well-to-do already manage to hold large amounts of housing space per person,[7] so that the weeding-out of the merely lucky "hoarders" would constitute a net gain for the benefit of those in distress. But it seems certain that the net gain would be much less than the gross, since many families in the income range above $4,000-$5,000 whose present housing is well above minimum standards would neverthless demand additional housing space in an uncontrolled market. Finally, and perhaps most important, vacancies would again exist, probably at all rent levels, and the waste of time and effort in finding a place to live would be largely eliminated, as would the unsavory elements of bribery and tie-in deals.

It does not appear to the present writer that these possible gains are suffi-

[4] Friedman and Stigler, *op. cit.*, p. 17.

[5] It might further be argued that rents will rise higher on new housing if old housing continues to be controlled, but this would appear desirable rather than otherwise, in that it would give additional impetus to the increase in supply.

[6] This would not constitute "hoarding," as we have defined it in terms of holding more housing than would be held under a more normal set of relative prices; but it is hardly better, if the problem is to provide adequate amounts of housing space for a larger number of people.

[7] There have been no controls on housing units renting for more than $300 per month.

cient to justify the disadvantages of general de-control, namely:

(1) The very large and completely unearned increment which would accrue to landlords as a class;

(2) The additional misery that would be heaped on the heads of certain fixed-income groups, and of the large group of unorganized or weakly organized workers, whose incomes have by no means kept pace with the cost-of-living increases already experienced with respect to food and clothing; and

(3) The additional impetus to inflation that would grow out of further wage demands consequent upon a further rise in rents.

The second and third of these disadvantages of general de-control are almost universally admitted and deplored. The first, the inequity of the resulting redistribution of income in favor of landlords, is subject to some argument. It is asserted first of all that the business expenses of the landlord (janitor service, repairs, fuel, taxes) have risen, and that in addition he has suffered along with the rest of the population from increases in his cost of living. If it is true that business expenses have risen by more than the rise in income which results from a lower vacancy rate, that would appear a good argument for permitting some increase in rent ceilings, but it hardly justifies removing them entirely. There might even be an argument for a further rise in ceilings to protect the landlord in some measure from increases in the cost of living. It would, however, be hard to maintain that the landlord "deserves" any greater increment of income than these two adjustments would involve.

Another more philosophical attack can be made on the notion that an unearned increment to the landlords is involved in rent de-control. This runs in the following terms: The market itself, in determining the value of any good or service, best measures the economic contribution of its supplier, and thus the compensation to which he is entitled. Therefore the market in and of itself provides the best available criterion of equity. Such an argument would of course equally condemn any sort of price control or profit limitation under any conditions. The principle seems fairly acceptable by and large, under ordinary circumstances, in a reasonably competitive system; but in specific cases it would work remarkably badly. For instance, if the greater part of the food supply of the country were destroyed by a series of catastrophes, it would be unthinkable to permit those who happened to control the remaining supplies to charge whatever prices they could get. No one could defend their right to such prices on grounds of equity, or maintain that such prices measured their economic contribution.

It might be worth while to digress sufficiently here to suggest some criteria for determining when a government may be justified in superseding the pricing mechanism of the market with respect to a particular good or group of goods. Such a step could be justified:

(1) If abnormal [8] interference with the processes of supply or an abnormal increase in demand has brought about a very high return with relation to cost of production [9] at the uncontrolled market price; and

[8] "Abnormal" here implies both that the shift from the normal situation is of major proportions and that it is not permanent in nature.

[9] *Not* cost of reproduction.

(2) If the good or group of goods is highly essential and accounts for a considerable proportion of consumer expenditures, so that substantial distress would result from unduly high prices.

Under these conditions, a government should be able to fix prices and rates of return more equitably (according to ordinary intuitive notions of social justice) than the mechanism of the market. A majority would probably agree that both criteria are satisfied in the case of rent control at the present time.

One point, however, remains to be made. If the government steps in to prevent entrepreneurs from realizing abnormal profits under abnormally favorable circumstances, but does nothing to prevent abnormal losses in abnormally unfavorable ones, the effect is to lessen somewhat the incentives to undertake production. The present writer inclines to the belief that the prospect of abnormal profits owing to wartime shortages is a relatively unimportant factor in the motivations of the entrepreneur in normal times, so that the elimination of such abnormal profits will not affect greatly his incentive to produce.

Objections to Public Rationing of Housing

If rent de-control is rejected as a means for redistributing existing housing space, there remains the alternative of public rationing of housing. It is fairly obvious that in peacetime this would be politically unacceptable in the United States, as well as being administratively troublesome. Obtaining and checking the requisite information as to housing space available and persons occupying it would be a tremendous and expensive task in itself. It would undoubtedly encounter some resistance. Much greater resistance would arise when the point was reached of actually obliging well-housed families to move or to share their quarters with others less fortunate.

Certain aspects of British World War II experience lie in this general direction. There was no over-all house rationing program, but two specific steps were taken. First, empty houses were commandeered for the use of war workers and bombed-out families, and eventually for any families inadequately housed.[10] Second, certain areas of acute shortage were declared "compulsory billeting areas." Each householder in such an area was required to state the number of rooms in his house, and to give the name and relationship to himself of every permanent resident. Those with surplus space ordinarily took in additional residents voluntarily, but in some cases compulsory billeting was actually practiced.[11] David Anderson in the *New York Times* of August 10, 1943, estimates that out of a million persons billeted up to that date, there had been 16,500 compulsory cases. The question of determining who, in a compulsory billeting area, was to be compelled to lodge the additional residents seems to have been left largely to the discretion of the local authorities.

Incentive Tax Plan

The purpose of the present paper is to offer an incentive tax plan as a third

[10] Ministry of Health Circular on Requisitioning Empty Houses, August 10, 1943.

[11] Richard Reiss, *Wartime Housing, Rent Control, and Billeting in Great Britain*, (London: British Information Service, 1942).

alternative. The plan will first be outlined briefly. It will later be explained, defended, and analyzed as to possible difficulties. Under this plan:

(1) The present system of rent control would be retained.

(2) Cities and towns suffering from acute housing shortage would impose an excise on housing. This might be thought of either as an excise on the consumption of a commodity (more precisely, a service) or as a tax on the privilege of occupying housing.[12] The tax would be collected annually from the householder (the occupier rather than the owner) and would be in the neighborhood of 3 per cent of the value of the housing facilities occupied.[13]

Consumption (or occupancy) of housing should be sufficiently broadly defined to include cases in which the premises are held vacant for the purposes of the owner or tenant. A tenant who leaves his house vacant while he takes a long trip, or an owner who holds his house vacant rather than offering it for rent, would be considered as consuming (or occupying) the housing in question, and would be subject to the tax.

(3) Occupiers of housing could qualify for partial or complete exemption from this tax in accordance with the following schedule, which is based on the "degree of occupancy" of the property:

Excess of Number of Rooms over Number of Residents	Proportion of Tax from which Occupier May Claim Exemption
1	All
2	Two-thirds
3	One-third
4 or more	None

A room should be defined in the ordinary (Census) way, unless the average size of rooms in a dwelling unit should exceed 200 square feet, in which event each 200 square feet of floor space should constitute a room for the purposes of the above table. A "resident" of a dwelling unit should be defined as a person living there for nine or more months of the year for which the tax is being collected. In the case of lodgers remaining for less than nine months, proportional credit might be given according to the length of their stay. Thus, if a room were rented to a succession of individuals for a total of more than nine months of the year, the several lodgers would be counted as a single resident.[14]

(4) If a tenant were unable to avail himself of the exemptions because his landlord prevented "full occupancy" of the rented premises, e. g., by refusing the tenant permission to sublet, this would entitle the tenant to a reduction in ceiling rental (per month) equal to one-twelfth of the (annual) tax exemption so lost.

(5) The taxes collected from persons failing to qualify for exemptions would

[12] I am indebted to Professor Harold M. Groves for the suggestion that the tax take this particular form.

[13] In the case of apartment houses, this would require us to assign to each apartment a proportion of the total value of the building. The proportion assigned to an individual apartment might be, for instance, equal to the proportion of the total rent represented by the rent on that apartment.

[14] The precise computations could be carried out in the following way: any lodger remaining in a dwelling unit less than nine months of a given year would be counted as a fractional person equal to the fraction of a year for which he lived there, and any group of lodgers totalling more than three-fourths of a person would constitute a resident.

be set aside for use in subsidization of local housing projects.

Constitutionality of Plan

The first questions which arise are those of the constitutionality, first of the proposed tax, and second of the proposed exemptions.

The proposed tax, if conceived of as a property tax, would violate the "uniformity" provision found in most state constitutions, which requires that all property be taxed in proportion to value. Under such a provision, it would be impossible to impose an additional *property* tax on housing without imposing it at the same time on all other types of property, real and personal. Furthermore, it would be impossible to exempt "fully occupied" housing from the additional property tax without exempting it from all property taxes whatsoever [15]—a gesture which few states or localities can afford, and not permissible in any case unless the state constitution permits considerable legislative discretion in determining the classes of property eligible for exemption. (Many states limit exemptions from the property tax to those specifically provided in the constitution.)

It is important, therefore, to distinguish clearly the tax proposed here from a property tax. It is easy to find cases in which distinctions of a somewhat similar sort have been made and upheld. For instance, there is widespread precedent for considering the inheritance tax as an excise on the privilege of succession, and thus distinguishing it from a tax on the property of the decedent.[16] There is also precedent for distinguishing a tax on the privilege of operating a railroad from a tax on the property of the railroad, [17] and an occupation tax on merchants [18] or liquor dealers [19] from a property tax on their stock in trade. It seems equally logical to distinguish an excise on the consumption of housing or on the privilege of its occupancy from a property tax on the house itself. The fact that the tax in question is to be collected from occupiers rather than owners adds, of course, to the validity of the distinction.[20]

There is little question that the consumption of housing (or the privilege of occupying housing) is a proper subject of excise taxation, unless the state constitution specifically limits the types of taxes which may be imposed. On the subject of the state's broad powers to tax, Cooley says: "For while a State may tax all persons as such, and all property as such, it may also tax all occupations, all amusements, and the very enjoyment of customary rights and privileges." [21] There is unquestionable precedent for taxation of the

15 The effect of a partial exemption from property tax would be to tax "fully occupied" housing at a lower rate than other property, thus violating the uniformity provision.

16 Thomas M. Cooley, *A Treatise on the Law of Taxation*, (Chicago: Callaghan and Co., 3rd Edition, 1903), pp. 34 f. See also *Wilmerding's Estate*, 117 Calif. 281; *Minot* v. *Winthrop*, 162 Mass. 113; *Union Trust Co.* v. *Wayne Probate Judge*, 125 Mich. 487; *State* v. *Henderson*, 160 Mo. 190; *State* v. *Ferris*, 53 Ohio St. 314.

17 Cooley, *op. cit.*, pp. 1121, 302.

18 *Ibid.*, pp. 1117, 303, 311.

19 *Ibid.*, p. 1113.

20 The fact that the tax is based on the value of the housing facilities occupied would of course militate in the opposite direction, but this value would seem a reasonable basis for measuring the amount of housing consumed or the value of the privilege of occupying it.

21 *Ibid.*, p. 411.

consumption of such commodities as tobacco, liquor, and gasoline, and such services as amusements. There is wide precedent for taxation of such privileges as that of pursuing a particular occupation.

Furthermore, it is well established that an excise tax is not subject to the restrictions placed upon property taxes. Classification is permitted subject only to the restriction that the basis of classification be reasonable.[22] Thus it would be perfectly permissible to tax the consumption of housing (or the privilege of occupying housing) without taxing other items of consumption and other privileges, or at different rates from other items of consumption and other privileges.

The question still remains as to the constitutionality of the proposed exemptions. The effect of the total and partial exemption is to classify housing on the basis of "degree of occupancy," and to impose different rates of tax on each class. Whether or not this constitutes a reasonable classification would have to await judicial determination, but in view of the purposes of the law, the writer feels that a good case can be made in its favor.

The constitutionality of the proposed arrangement in any particular state will depend upon the constitutional provisions and judicial rulings of that state. In Wisconsin, the only state for which the problems raised have been investigated in connection with this paper, it seems entirely probable that such a tax would be upheld.

In the first place, the Wisconsin constitution specifically provides for excise taxes and states further that "reasonable exemptions may be provided," so that legislative discretion in the matter of exemptions is retained.[23] According to a judicial ruling: "An excise tax is a tax laid on the manufacture, sale, or consumption of commodities within the country, on licenses to pursue certain occupations, and on corporate privileges, and is a privilege tax, as distinguished from a property or capitation tax. The word 'privilege' is broad enough to cover any species of tax except property and capitation taxes, and is used with such effect in the Constitution." [24] A further ruling states that the uniformity rule in taxation, if applicable to excise taxation at all, means no more than that such taxation shall operate alike on all persons similarly situated.[25] (Classification is therefore permitted so long as there is uniform treatment within classes.)

A ruling which establishes that an occupation tax on grain in elevators and warehouses is not a property tax on this grain (and therefore not subject to the uniformity restrictions of the property tax) should provide precedent for the claim that a privilege tax on housing is not a property tax on the house occupied.[26]

Finally, there is a ruling which states that "A classification of persons for

[22] *Ibid.*, pp. 275 (Alabama), 279 (California), 284 (Georgia), 287 (Illinois), 297 f. (Louisiana), 302 (Massachusetts), 308 (Mississippi), 313 (Montana), 321 (North Carolina), 331 (South Carolina), 333 (Tennessee), 335 (Texas), 336 (Utah), 337 (Virginia), 338 (Washington).

[23] *Wisconsin Constitution*, Art. VIII, Sec. 1.

[24] *Wisconsin Statutes* (1945 edition), p. 55 n., discussing *State ex rel. Froedtert G. & M. Co.* v. *Tax Commission*, 221 Wis. 225.

[25] *Wisconsin Annotations* (1930 edition), p. 95, discussing *Nunnemacher* v. *State*, 129 Wis. 190.

[26] *Ibid.*, p. 94, discussing *State ex. rel. Bernhardt Stern & Sons* v. *Bodden*, 165 Wis. 75.

purposes of taxation must be based on reasonable differences or distinctions which distinguish the members of a class from those of another in respects germane to some general and public purpose or object of the particular legislation."[27] This would seem to imply that classification of housing according to "degree of occupancy" would be reasonable so long as it could be shown that the distinction between "fully occupied" housing and housing not "fully occupied" was germane to some general and public purpose of the proposed legislation. This should not be difficult.

Details of Plan

Once the question of constitutionality is settled, the remaining questions are mainly of administrative detail. Perhaps the most important of these involves the size of the tax. Since the primary object is redistribution of housing space, rather than collection of a little money for public housing, the tax should be large enough to play a significant part in the decisions of a substantial number of people. The figure of 3 per cent of the value of the housing occupied is admittedly a guess, and used mainly to give a concrete basis to the discussion. On a house worth $10,000, the tax would amount to $300 a year, or $25 a month. If such a house rented for $100 a month, the tax would be equivalent to a 25 per cent increase in rent, and this should be enough to produce some results.

There are several reasons for making the tax depend upon the value of the housing occupied. First, this value supplies a reasonable measure of the amount of housing consumed. Second, it may be estimated easily and without expense or inconvenience from the records of assessed valuation. (In case assessments are made customarily at a fraction of fair market value, it will still be simplest to use assessed valuation as a base, and apply a correspondingly higher rate.)

In many ways it would be neater and more elegant to impose a flat rate per room on all rooms in excess of the number of residents plus one. However, this would require information as to number of rooms and number of residents, information not already available and not obtainable without expense and the antagonism of the householder. It is one thing to permit the householder to present such information if he chooses, in order to obtain exemption from the tax. It would be quite another thing to try to obtain it from him as a preliminary to laying a tax.

Two further advantages of an ad valorem over a flat rate tax are worthy of some consideration. One minor inequity of this plan as presented is that rooms of all sizes are treated identically, so long as average room size does not exceed 200 square feet. This is clearly unfair to occupants of houses with unusually small rooms, but the inequity is corrected partially by the fact that such houses will be relatively low in value, so that the tax will be correspondingly low. Secondly, people living in valuable houses will in general require more persuasion than others before they will take any action toward fuller utilization of their housing facilities. An ad valorem tax tends in the direction of greater pressure on these people.

[27] *Wisconsin Statutes* (1945 edition), p. 56 n., discussing *Welch* v. *Henry*, 223 Wis. 319.

Some further discussion of the definition of "room" may be in place here. It does not seem worth while to set up detailed specifications for determining such points as when the dining space is to be counted as a separate room and when as part of the kitchen or living room. In general, bathrooms, closets, halls, and unheated screen porches should not be considered rooms, and any space which reasonably could be considered to fall in one of these catagories should be eliminated from the calculations. If necessary, an upper limit may be set on the total area of floor space thus eliminated. Attics and basements may be considered rooms if adequate heat, light, and ventilation are available, and in the case of basements, if they are not subject to flooding or unduly damp. In cases of real doubt as to whether a given space constituted two small rooms or one large one, a criterion in terms of total area could again be used. For example, if less than 200 square feet are involved, it might be considered one room, and if more, two rooms.

The provisions that each 200 square feet of floor space shall constitute a room in case rooms are unusually large is not intended for general use. It is inserted simply to provide some check in special cases where a simple count of rooms as ordinarily defined is felt to overestimate gravely the degree of occupancy. It would be possible to introduce provision for the protection of householders whose rooms are unusually small, if the inequities to these people are sufficiently important.

The definition of "resident" needs no particular defense except the explanation of the partial credit given for lodgers remaining less than nine months, while no similar credit is given for family members. An important object of the plan is to encourage the renting out of rooms to lodgers, and it would be most unfortunate if householders found that it did not pay them to do this unless the lodger could guarantee to stay for at least nine months. On the other hand, there is no reason to encourage extended visits from relatives who maintain quarters elsewhere, in which they are counted as residents. Determination of the number of residents would be simplified considerably if the tax were collected monthly, but this would involve much greater inconvenience for the taxpayer and is not suggested for that reason.

A word of defense is in order for setting the exemptions in terms of the excess of number of rooms over number of residents, rather than in terms of the more common concept of persons per room. The reason for this becomes clear when one considers how different the situation is as between two persons living in four rooms and five persons living in ten rooms. The number of persons per room is exactly the same in both cases. The first household may consist of two bedrooms, a living room, and a kitchen. This hardly seems unreasonable, although one of the bedrooms might be dispensed with. The second household allows a private bedroom for everyone, though it would not seem unreasonable to expect at least two of the five to share a bedroom. In addition, there is opportunity for a kitchen, living room, dining room, library (study, den), and game room or sun parlor. It is recognized that the measure which has been substituted for the number of persons per room discriminates slightly against the larger family which needs more

room than the smaller for non-sleeping purposes, but the larger family is also in a position to gain this extra space by doubling up in bedrooms.

The precise level which is considered "full occupancy" can of course be made dependent on the seriousness of the housing shortage in the particular community. For illustrative purposes in this paper, full occupancy has been considered to exist when the number of rooms do not exceed the number of residents plus one.

Advantages of Plan

The advantages of this plan are of two sorts. First, increases in housing cost are limited to cases in which they can operate to improve the situation. Under rent decontrol, many increases in housing costs would do nothing to improve the utilization of existing facilities. Removal of ceilings on new housing is acceptable (despite the harm to those who rent it) insofar as it is necessary to bring about increase in the supply. Higher housing cost for those not utilizing their facilities fully is necessary in order to persuade these people to use their space more economically. But higher housing cost for those already occupying fully the space available to them contributes nothing to the solution of the problem and may inflict considerable hardship. Insofar as it reduces at all the housing space used by this group, it merely forces undue crowding on one family in order to relieve it for another.

Second, as compared with the rationing of housing, the present plan has advantages of greater public acceptability and greater ease of administration. In the United States in peacetime, the rationing of housing would be "regimentation" and "outrageous government interference" with the privacy of the home and the sanctity of the family. Furthermore, as regards administration, the burden of proof under this tax plan would lie with the householder rather than the government. The property owner or occupier would be in the position of asking for something. He would have to take the initiative in bringing forward the relevant evidence on degree of occupancy, and would have to submit gracefully to the checking of his statements by the proper authorities.[28]

The final point to consider in evaluation of this plan is its expected effectiveness in redistributing housing space. This would depend very largely on the size of the tax considered to be politically feasible, and on the incentive provided by exemption from it. If the exemption were large enough to be felt with any acuteness, its effect would take the following forms:

(1) Renting out of rooms to lodgers (at free market rents) would be encouraged. From the householder's point of view, the rent obtained would be increased automatically by the added exemption obtained. If a room in a $10,000 home were rented to a couple at $40 per month, thus qualifying the householder for a two-thirds exemption on a 3 per cent tax, the effect would be to increase his return to $56.67 per month, or by about 40 per cent. Even in the case of a 2 per cent tax, the effective rent would rise to more than $50, a

[28] Veterans' organizations and their auxiliaries would undoubtedly be happy to take over a good deal of the routine detail in connection with this checking.

25 per cent increase. Thus it would not require a very large tax to produce some effect in increasing the number of rooms available for rent, particularly to couples. By reducing the demand of couples and single persons for small apartments, the plan would reduce indirectly the pressure in that area also, to the primary benefit of larger family units.

(2) Single women (or men) with apartments would be encouraged to take in roommates. A fairly small rise in housing cost might induce one working girl in a three-room apartment to take in a roommate, or two girls in a four-room apartment to take in a third. The exemption achieved in such cases would amount to only one-third of the tax, and the tax base would presumably be low, so that the saving would not be very great. The one- and two-room apartments occupied by single persons would not be affected, but occasional individuals and families holding two or more apartments in shortage areas might be induced to limit their holdings to a single unit.

(3) Families would be induced in some cases to move to smaller quarters, especially if their present dwellings were large enough to subject them to the full burden of the tax. The size of the saving necessary to make this effect important would depend on the ease of finding smaller quarters. Probably nothing less than a 20 per cent increase in housing cost would be very effective. The result in this case would be to increase the number of large apartments available at the expense of the number of smaller ones.

(4) Families would be encouraged to move in with relatives or friends, especially if both family units would otherwise be subject to the tax. The cases of parents-in-law and working adolescents would be typical, and a small percentage increase in housing cost would probably be more effective here than under (3) above. The result would be a clear gain in the number of housing units available.

Under the lure of exemptions equal to 3 per cent of the market value of residential property, a substantial improvement in the number of rooms for rent and a somewhat smaller improvement in the number of apartments available could be expected to result from shifts of these four types.[29]

[29] Since this was written the writer has learned of several similar plans to employ special excises to meet problems of shortages and decontrols. For the United States Professor Modigliani has drawn up one such proposal designed to alleviate a meat crisis forecast for the summer of 1948. In France, Professor Allais has developed more general tax proposals as a part of a plan of general price decontrol.

STATE INCOME TAX SIMPLIFICATION IN VERMONT

J. K. LASSER *

THE present unprecedented revenue needs of the Federal and state governments have brought within the scope of the income tax many millions of new taxpayers. Many of them have little or no experience in the preparation of a tax return. At the same time the complexity of our economic society has resulted in an ever increasing number of rulings and interpretations concerning the elusive concept of taxable income. As a result, millions approach the problem of tax reporting with dread. It is detrimental to our national temper to require those who have weathered the difficulties of preparing the Federal tax form to prepare an entirely separate state return. This is especially true where the state law differs from the Federal.

A common sense approach to the problem has long been needed. Recent years have witnessed a trend in a number of states toward simplified income tax reporting. A comprehensive income tax simplification program has recently been adopted by Vermont.

The Proposal of the Governor of Vermont

In January, 1947, the inaugural address of the recently elected governor of the State of Vermont, Ernest W. Gibson, included a proposal to revise and simplify the tax laws of the State.[1]

The Vermont income tax law in force divided income, broadly, into two classes, earned and investment income.[2] Each had different deductions and exemptions, some of which had to be prorated over both classes. The tax was at a fixed, non-graduated rate; capital gains and losses were excluded; various types of income were exempt; the Federal income tax was deductible. These and other adjustments made it necessary for each taxpayer to know two tax laws—the Federal and the State. Furthermore, it was widely believed throughout the State that the tax produced an inequitable result. The Governor's proposal to simplify the tax law was in a large measure adopted by the legislature.

What the Governor wanted was a simple tax law; a complementary return of the utmost simplicity for the taxpayer; ease and stability of administration. This meant the greatest possible integration of the State law with the Internal Revenue Code.

The problems encountered in the development of the new law are presented here in the belief that the mechanics of the transition will be of interest.

Constitutional Questions Involved

The first stumbling block was the constitutional question raised by the proposal to incorporate Federal income definitions into the State law by reference. Although the Vermont constitution contains no specific ban on incorporation by reference, there was still a problem of a possible implied ban on incorporation by reference. It was believed that the problem of adopting the

* The author, a certified public accountant of New York City, served as a consultant to the Governor of Vermont in connection with the legislation discussed in this article.

[1] January 9, 1947.

[2] Chapter 39, Public Laws, Sec. 872-885, as amended.

definition of net income as provided in the Internal Revenue Code could be solved by one of the following methods:

(1) Have the State legislature determine the amount of personal exemption for the taxpayer, the credits for dependents, and the tax rate. Then the law would not be declared invalid solely because the State law incorporated by reference the Federal definition of net income. The Vermont Supreme Court had indicated that a tax law should be construed liberally, so as to uphold it if possible.[3] But because this proposal left too much to chance, it was not wholly satisfactory.

(2) Have the State tax law incorporate the definition of net income as presently contained in the Federal law.[4] This could be reenacted by subsequent sessions of the legislature. But the sessions of the legislature are biennial and basic changes might possibly be made in the Federal law between sessions.

(3) Have the law give an election to the taxpayer, to use the then current Federal net income, which would incorporate all future changes in the Federal tax law.

In the final drafting of the tax bill, the Vermont legislature provided that "net income" and "adjusted gross income" have the same meaning as under the Internal Revenue Code.[5] Since the tax is based upon net income and not on adjusted gross income, the "severability" provision[6] of the law should protect the revenue. If the law is contested as to constitutionality, the provision concerning adjusted gross income should furnish the court a suitable vehicle for resolving this unsettled question.

A second constitutional question arose with respect to interest on United States obligations. A large part of such interest is included in the Federal definition of net income. Generally, a state may not levy a direct tax upon Federal obligations or upon income from them.[7] However, some authorities apparently believe that this income is taxable by the states, or they anticipate the sanctioning of such taxation by Congressional or judicial action. For example, Georgia has deleted the provision relating to the exclusion of interest on United States Government obligations from gross income.[8] In the final drafting of the bill, the Vermont legislature excluded income on United States obligations from net income.[9]

3 *Clark, et al.* v. *City of Burlington, et al.*, 101 Vt. 391, 143 Atl. 677.

4 See, for example, *Featherstone* v. *Norman*, 170 Ga. 370, 153 S. E. 58, 70 A.L.R. 449.

5 Chapter 42, Vermont Statutes, 1947, Sec. 1—F: "'Net income' means the same net income as now defined under the Internal Revenue Code but excluding income which under such code is expressly exempted from taxation by the states; and also excluding capital gains and losses; and provided that, if the taxpayer so elects, 'net income for any taxable year' means the same as net income, as defined under the laws of the United States in effect for such year, with the exceptions above noted; from net income as herein-before defined the taxpayer may deduct not exceeding $500.00 of Federal income taxes paid or accrued within the taxable year."

Sec. 1—G: "'Adjusted gross income' means the same as adjusted gross income as now or hereafter defined under the laws of the United States, without consideration of either a capital gain or capital loss."

6 Chapter 42, Vermont Statutes, 1947, Sec. 17—II: "If any provision of this act or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are declared to be severable."

7 *Miller et al., executors* v. *Milwaukee*, 272 U.S. 713, 47 Sup. Ct. 280.

8 Act 195, Acts 1941, amending Sec. 92-3107 (b) (5).

9 Chapter 42, Vermont Statutes, 1947, Sec. 1—F (*supra*, note 5).

The Compromise Bill Adopted in Vermont

The Governor's recommendations met with some criticism when presented to the legislature. Objection was raised to the theory of tying the State law to the Internal Revenue Code, but the State law had already adopted almost every important provision of the Internal Revenue Code, particularly the concept of gross income and allowable deductions. It is difficult to perceive what "loss of independence" there is in adopting a few minor provisions of the Internal Revenue Code, especially when the really vital issue of tax rate is determined exclusively by the State legislature.

The Vermont legislature was reluctant to change the existing procedure of excluding capital gains and losses and of allowing the Federal income tax as a deduction. It could be argued that the tax is based upon ability to pay and that the line of demarcation between ordinary income and capital transactions is exceedingly vague. Furthermore, under the Federal code, 50 per cent of long term capital gains are not taxed. Allowance of a deduction for Federal income tax paid is theoretically sound. But since the State tax rates are low and the resulting tax is in turn deductible in computing Federal tax, the allowance made little actual difference. It did not appear to warrant a deviation from the purpose of the proposed bill—to simplify tax reporting.

The compromise bill finally passed provided for the exclusion of capital gains and losses. It also granted a deduction for Federal income tax paid, not to exceed $500. It further provided an additional exemption of $500 for taxpayers over 65 years of age. These few adjustments complicated the problem of designing a simple reporting form. The amount of capital gains and losses excluded must be disclosed on the tax form. The instructions are burdened with the additional explanation. Fortunately, the majority of taxpayers can use the simple form, untroubled by these complications.

The Vermont bill is an important experiment in state tax reporting. It is unfortunate that the provisions of the bill as originally proposed were not retained in full so that the results could be measured and analyzed. Nevertheless, it will be most instructive to study the course of the new law. It applies to income received beginning January 1, 1947.

Technical Problems

The entire effort to simplify the tax had to be reflected in the tax form itself. That presented these problems:

(1) A single form had to be designed which would accommodate three types of taxpayers:

a. those who reported on Federal Form W-2 (withholding statement);
b. those who used the tax table on Federal Form 1040; and
c. those who used the Federal "long form" (separately listing deductions).

(2) This simple form had to be tied in with the Federal return. The accompanying instructions had to make the transition as simple as possible.

(3) The new method had to require the least amount of readjustment in the administration and processing of the return.

The result of these studies is a tax form with but ten lines. Four of those lines are for the usual informational

questions. The form and instructions are reproduced in the accompanying figure. (An optional tax table for persons with gross incomes under $5,000, similar to that on the Federal form, is not reproduced here.)

Form 103
Vt. Tax Dept.

VERMONT INCOME TAX RETURN

FOR CALENDAR YEAR 1947 OR FISCAL YEAR ENDING ______________ 194__

1. Gross Income, Federal Form W-2, Line 3; or Form 1040, Line 6 __________ $__________
2. Net Income, Federal Form 1040, (Sch. D Capital Gains and Losses $________ omitted) __________ $__________
3. Less: Federal Income Tax paid (Not over $500) __________ $__________
4. Other Deductions __________
5. Credit for ______ exemptions at $500 each. (See instructions) __________
6. Net Taxable Income __________ $__________
7. Enter amount of your tax on this line. (See instructions) __________ $__________
8. Occupation __________ 9. Social Security Number __________

PRINT NAME AND ADDRESS HERE

10. Give name and address of husband or wife if separate return is being filed.
____
____

I declare under the pains and penalties of perjury that this return has been examined by me and to my best knowledge and belief is a true, correct and complete return.

____
Signature

Detach and forward this copy to Commissioner of Taxes

HERE IS WHAT YOU NEED TO KNOW TO FILE THIS RETURN

A. WHO IS REQUIRED TO FILE A RETURN:

(a) *Single person*, receiving income of $500 or more.
(b) *Married but not living with husband or wife, same as* (a).
(c) *Married and living with husband or wife*, combined income $1,000 or more.
(d) Non-residents; same as above provided income is received from occupation, trade or business within this state.
(e) Partnerships, use Form 105
(f) Open estates, same as (a).
(g) Trusts, use Form 109.

B. PERSONAL EXEMPTIONS:

$500 to each person. Husband, wife and one child would be $1500. $500 additional if taxpayer is over 65 years of age.
$500 to each open estate, $100 to each trust.

C. FILING OF RETURNS:

Returns must be mailed to Commissioner of Taxes, Montpelier, Vt., on or before March 15 for calendar year preceding.

D. PAYMENT OF TAX:

Check or money order payable to Commissioner of Taxes must accompany return.

E. INTRUCTIONS FOR EACH LINE OF RETURN:

Line 1. Enter here the amount reported on Line 3 of Form W-2 (Withholding Statement), or Line 6, P. 1 of Federal Form 1040. If this amount is less than $5000, you may elect to pay your Vermont tax in accordance with the table on the reverse side of this sheet and skip lines 2, 3, 4, 5 and 6. For example: $3000 earned, husband, wife and one child. See Column 3 of table. Tax would be $13.

Line 2. Net Income is that reported on Federal Form 1040, Page 3, Line 3; less Capital Gains and plus Capital Losses.

Line 3. Enter here the amount of Federal Income Tax paid but not over $500.

Line 4. Enter here any interest received from U. S. Government obligations.

Line 5. Enter here total exemption claimed. For example: husband, wife and one child, $1500.

Line 6. This is the amount which is subject to tax.

Line 7. The amount in Line 6 is taxed as follows:
1% first $1000, or part thereof, 2% next $2000, 3% next $2000, 4% of all over $5000. For example, should the amount on Line 6 be $2250, the tax would be $35. ($1000 at 1%, $1250 at 2%.)

The first line is used by those who report to the Federal Government either on Form W-2 or by using the tax table. If the gross income is less than $5,000, a single figure from the Federal return is used. The State tax is then found on an optional tax table on the return, by looking in the column under the appropriate number of exemptions. The exemptions and credits for dependents are the same as those allowed on the Federal return, except the $500 additional State exemption given a taxpayer over 65 years of age. The tax is entered on line 7 of the return.

The second line is used by those reporting to the Federal Government on the "long form." They pick up the amount of income from page 3, line 3, of the Federal return, which consists of net income after all deductions. Provision is also made on line 2 for elimination of capital gains and losses. Lines 3, 4, and 5 are for deductions for Federal income tax, interest income on Government obligations, and exemptions, respectively. Tax is figured at the rates given on the return. Each of

these steps is clearly and concisely explained in the instructions on the return.

The instructions are simple. Since adjusted gross and net income, personal exemption, and credit for dependents are generally the same as those on the Federal return, the instructions are almost identical with those of the Federal return.

The vast majority of taxpayers receive incomes of less than $5,000. The graduated rates of Vermont tax begin at 1 per cent and rise to a maximum of 4 per cent on all income over $5,000. It is apparent that the average amount of State tax on an individual return will be a relatively small sum. This is all the more reason for making the task of reporting to the State as easy as possible. To encourage the use of the optional tax table, allowance is made for ordinary deductions and for Federal taxes paid, as well as for exemptions. It is believed that the advantage of simplicity of compliance and administration will more than offset any loss of revenue resulting from widespread use of the optional tax table.

Administration and Processing of the Tax Form

More efficient tax administration is a natural consequence of the new law. It is possible, with proper liaison with the Federal Collector of Internal Revenue to determine whether all persons liable have filed a tax. Approximately the same number of taxpayers who report to the Federal Government should likewise report to the State. It is therefore possible to detect and prevent a great deal of tax evasion and avoidance. This previously had constituted a sizable problem. Furthermore, the simplicity of the new proposed law appealed to the administration. It will no longer be necessary to explain the separate and complicated provisions of the State law. The new laws are fully explained to the public through local newspapers. The problem of processing the simplified returns is greatly lessened. The number of Vermont people who will report is expected to increase materially, because of the decrease in personal exemption. This may present an administrative problem, but the disadvantage is more than offset by the additional revenue produced, the necessity for which had been a prime consideration in the entire program.

Conclusion

The time is over-ripe for simplification of our state tax laws. A number of states have taken steps in that direction. For example, New York has recently adopted the principle of a standard deduction. Oklahoma has adopted optional tax tables. These are steps in the right direction, but they do not go far enough. Legal and technical difficulties undoubtedly are part of the reason for such halting progress. But there is also some reluctance to forsake the comfort of an established routine. Perhaps time-worn systems will yet be recognized as outmoded and a wholly unnecessary burden on the taxpaying citizens lifted.

Vermont's new tax law recaptures some of the pioneering spirit characteristic of this nation. It contains this unusual language: "It is hereby declared that the purpose of this act, in addition to the essential purpose of raising revenue, is to conform as closely as may be with the Internal Revenue Code, in order that the filing of returns may be simplified and the taxpayers' accounting burdens may be reduced."

FEDERAL TAX LEGISLATIVE ACTIVITIES IN 1947

RICHARD GOODE *

ALTHOUGH only one important Federal revenue act became law during 1947, the year was one of considerable legislative activity and debate and of general public discussion on tax matters. The single important revenue act taking effect during the year continued certain wartime tax increases, but other Congressional action and public discussion were concerned almost entirely with tax reduction. The Congress twice passed bills that would have made large tax reductions, but both bills were blocked by Presidential veto. The House Ways and Means Committee conducted extensive hearings on postwar tax revision. The Treasury Department released a number of staff studies dealing with various aspects of the tax system and possible revisions. A special tax study committee of experts recommended a series of important revenue revisions in a report to the Ways and Means Committee. State legislatures continued to influence Federal tax liabilities by the adoption of state community property laws permitting husbands and wives to divide income for tax purposes. As the year drew to a close, the chairman of the Ways and Means Committee introduced another important tax reduction bill, which was termed "veto proof."

Excise Tax Act of 1947

The only major revenue act that became law during 1947 was the Excise Tax Act of 1947.[1] By indefinitely extending certain war excise tax rates, this act increased Federal receipts by an estimated $1.1 billion in the fiscal year 1948.[2] Under prior law the war excise tax rates were scheduled to expire six months after the termination of hostilities. Since the end of hostilities had been officially declared by Presidential proclamation as of December 31, 1946, the expiration date for the war excises was June 30, 1947. These war excises were increases in tax rates provided by the Revenue Act of 1943. They included, among others, the increases in the taxes on furs, jewelry, and toilet preparations from 10 per cent to 20 per cent, the increase in the tax on admissions from roughly 10 per cent to 20 per cent, and the increase in the tax on distilled spirits from $6 to $9 a gallon.

On January 3, 1947, in his budget message for the fiscal year 1948, the President urged that the war excise taxes be continued, declaring that he considered it "essential that war excise-tax rates be retained."[3] At the same time, the President said, "When the time comes for excise-tax revision, the Congress should review the entire group of excise taxes rather than concentrate attention on those that were imposed or increased during the war."[4]

The Congress accepted the President's recommendation and, before be-

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[1] Public Law 17, 80th Congress, 1st Session (March 11, 1947).

[2] Statement of Secretary of the Treasury Snyder, *Individual Income Tax Reduction*, Hearings before the Committee on Ways and Means, House of Representatives, 80th Congress, 1st Session (March 13, and 14, 1947), p. 15.

[3] *Budget of the United States Government for the Fiscal Year Ending June 30, 1948*, p. M5.

[4] *Ibid.*, p. M11.

ginning action on a pending tax reduction bill, passed the Excise Tax Act of 1947, which indefinitely continued the war excise tax rates. This act also modified the tax on fur-trimmed coats and other acticles by providing that the tax should not apply unless the value of the fur is more than three times the value of the next most valuable component material. Previously, the fur tax had applied to the entire value of the article if the value of the fur exceeded that of any other single component. The act also amended the tax on transportation of persons by exempting transportation outside the northern portion of the Western Hemisphere, except for transportation between places in the United States, Canada, or Mexico.

H. R. 1, the Individual Income Tax Reduction Bill

On March 13, 1947, the House Ways and Means Committee began hearings on H. R. 1 (80th Congress, 1st Session), a bill introduced by Representative Knutson, chairman of the Committee. The bill would have reduced individual income tax rates for 1947 and later years by a flat 20 per cent for all taxpayers with taxable net incomes below about $302,400. The rate reduction for larger incomes would have been smaller, tapering off to 10.5 per cent above $5,000,000. The bill also included a special additional tax exemption of $500 for taxpayers over 65 years of age (or $1,000 in the case of joint returns, where both husband and wife were over 65 and each had $500 or more of gross income). It was estimated that the bill would reduce revenues by about $3.5 billion in a full year (assuming income payments of $166 billion).

In appearing as the first witness on the bill, Secretary of the Treasury Snyder opposed any general tax reduction at that time. He pointed to the rapid transition that had been made from wartime to peacetime production and the current high level of economic activity. He stated that, with the existing high levels of national income, taxes could be paid with less hardship than under other less favorable conditions. The Secretary stressed the large size of the public debt and the desirability of reducing it as rapidly as feasible in good years. In his formal statement, Secretary Snyder did not argue that tax rates should be maintained to help curb inflation, but in his prepared replies to certain questions put to him by the Committee chairman he made that point.[5]

The Secretary of the Treasury also opposed H. R. 1 on the grounds that it gave excessive relief to higher incomes as compared with lower incomes. He pointed out that the bill would wipe out most of the wartime tax increases on very large incomes but would leave in effect a substantial part of the wartime increases on lower incomes. He also took the position that making as large a reduction in individual income taxes as was provided by H. R. 1 might forestall the later adoption of desirable revisions in other taxes.

After brief hearings, the Ways and Means Committee amended H. R. 1 to increase the tax reduction to 30 per cent for the first $1,000 of taxable income. In order to minimize the revenue loss resulting from this provision, the 30 per cent reduction was applied only to those whose total taxable income was less than $1,000, rather than

[5] House Ways and Means Committee Hearings, *op. cit.*, p. 18.

to the first $1,000 of income of all taxpayers. In a notch area between $1,000 and approximately $1,400, the reduction fell rapidly from 30 per cent to 20 per cent. Minority members of the Committee filed a strong dissent from the favorable report of the majority.[6]

After an acrimonious debate, the bill was passed by the House of Representatives and sent to the Senate. In the Senate, the bill was still further amended by the introduction of a new bracket, covering taxable incomes between $79,700 and $302,400, for which the reduction was 15 per cent rather than the 20 per cent provided by the House bill. The Senate bill allowed only one-half of the reductions for the calendar year 1947 and the full reductions for later years.

As H. R. 1 emerged from conference and was finally approved by the Congress, it contained four distinct reduction brackets: (1) taxable incomes below $1,000, a rate reduction of 30 per cent; (2) taxable incomes between $1,000 and $1,400, rate reductions ranging from 30 per cent downward to 20 per cent; (3) taxable incomes between $1,400 and $136,700, a 20 per cent reduction; (4) taxable incomes in excess of $136,700, rate reductions falling from 20 per cent to about 10.5 per cent. These reductions were granted in full for 1948 and later years, but only one-half of the full reductions was allowed for 1947. For 1947 and later years, an additional exemption of $500 was allowed taxpayers over 65 years of age. It was estimated that, in its final form, H. R. 1 would reduce revenues by about $3.8 billion in a full year of operation.

H. R. 1 reached the President in June, and on June 16, 1947, he returned it without his approval. In his veto message the President held that tax reduction was not justified by economic conditions or by the budgetary situation. He also condemned H. R. 1 as inequitable and because it ignored tax problems other than those pertaining to individual income tax rates. The House of Representatives voted in favor of overriding the President's veto (268 to 137), but by less than the required two-thirds majority, so the veto was sustained.[7]

Issues Raised by H. R. 1

Although H. R. 1 did not become law, it may be worth while to examine briefly some phases of the public discussion of the bill. The Congressional debate and hearings seem to have had a noticeable effect on the content of the bill. Several important changes made between the bill's original introduction and final passage by the two houses of Congress can be traced rather directly to the discussions of certain important issues raised by the bill. These changes were concessions to a point of view held by the President as well as by some members of Congress, but the concessions were not sufficient to win approval of the bill by the President and two-thirds of the Congress.

The principal issue, of course, was whether 1947 was an appropriate time for tax reduction. This issue could be approached from two points of view. As a matter of budget policy, the question could be raised whether it would

[6] *Individual Income Tax Reduction Act of 1947*, Report of the Committee on Ways and Means, House of Representatives, 80th Congress, 1st Session, Report No. 180 (March 24, 1947).

[7] *Congressional Record*, Vol. 93, p. 7296 (June 17, 1947).

be possible to reduce taxes and at the same time achieve a budget surplus large enough to permit a respectable reduction in the public debt. From the point of view of broad economic policy, the question was whether tax reduction was appropriate or necessary in the light of existing and prospective economic conditions.

Congressional supporters of H. R. 1 asserted that enactment of the bill would still leave a large surplus for debt reduction. They attacked the budget estimates of government expenditures and receipts. The President's budget had put estimated expenditures for the fiscal year 1948 at $37.5 billion and net receipts at $38.8 billion (after allowance for the effect of the extension of the war excise tax rates). Supporters of H. R. 1 asserted that government expenditures would be considerably smaller than the President had estimated, but they did not agree among themselves as to the most likely figure. Confusion was increased by the failure of the two houses of Congress to agree on a legislative budget, as provided by the Legislative Reorganization Act of 1946.[8] The House Ways and Means Committee assumed that Federal expenditures in fiscal year 1948 would range between $31.5 billion and $32.25 billion.[9] The Senate Finance Committee computed the surplus on the basis of assumed expenditures of $33 billion.[10] The discussion was further obscured by a confusion between estimated *expenditures* and *appropriations*, which under certain circumstances may differ substantially.[11]

The assumptions as to government expenditures used in Congress to justify tax reduction do not seem to have been substantiated by experience. In January, 1948, with the fiscal year 1948 half over, the President estimated expenditures for the year at $37.7 billion,[12] which is slightly higher than his original budget estimate of $37.5 billion, made a year earlier.

The Treasury estimates of receipts under existing law were repeatedly challenged as being too low. Indeed, on the face of the matter, it did seem clear that either the revenue estimates were too low or the Secretary's appraisal of the economic outlook was too optimistic.[13] The passage of time has shown that the estimates of receipts were too low. In January, 1948, receipts for the fiscal year ending June 30, 1948, were estimated at $45.2 billion,[14] or $6.4

[8] Public Law 601, 79th Congress, 2nd Session, sec. 138.

[9] House Ways and Means Committee Report, *op. cit.*, p. 7.

[10] *Individual Income Tax Reduction Act of 1947*, Report of the Committee on Finance, United States Senate, 80th Congress, 1st Session, Report No. 173 (May 14, 1947), p. 5.

[11] Appropriations for a given year are based on obligations expected to be incurred during that year, but the corresponding expenditures may not be actually disbursed until a later year. At the same time, the current year's expenditures include payments arising out of obligations incurred under appropriations of a prior year. Consequently, expenditures will usually exceed appropriations in a period of declining government activities and be less than appropriations in a period of expanding activities.

[12] *Budget of the United States Government for The Fiscal Year Ending June 30, 1949*, p. A4.

[13] The Treasury revenue estimates were based on the assumption of income payments of $166 billion in the calendar year 1947; yet in January, 1947, income payments were already running at an annual rate of $177 billion. At the hearings, Secretary Snyder had said, "I do not believe anything at this time, in the next year, will indicate a material reduction in jobs." House Ways and Means Committee Report, *op. cit.*, p. 6. No one was bold enough to forecast a decline in prices as a means of reconciling the Secretary's view and the estimates of his technical staff.

[14] *Budget for the Fiscal Year 1949*, p. A4.

billion more than the estimate made one year earlier.

The disputes about the probable size of the budget point up the difficulty of legislating on the basis of expected future appropriations and the failure of the machinery established by the Legislative Reorganization Act to perform its intended function of providing the Congress an agreed basis for financial planning.

One outcome of the debate about the size of the budget was the provision of the final bill that made the contemplated tax reduction in two stages, only one-half of the reduction being allowed in 1947 and the full reduction postponed until 1948.

At the end of the calendar year 1947, it seemed that supporters of H. R. 1 had been right in contending that it would have been possible to have granted the tax reduction provided by the bill and at the same time have made a sizable payment on the public debt. With the fiscal year 1948 half over, the President estimated the surplus for that year at $7.5 billion and for the fiscal year 1949 at $4.8 billion (under then existing tax rates).[15] Whether these estimated surpluses were large enough to justify tax reduction, however, could not be decided as a matter of abstract budget policy. The appropriate size of the surplus and amount of debt retirement could be decided only in the light of an appraisal of the economic situation and the economic effects of tax reduction.

The economic aspects of the timing of tax reduction were not neglected in the debate about H. R. 1. Both the House Ways and Means Committee and the Senate Finance Committee defended the bill by arguments which implied (although they did not explicitly so state) that supporters of the bill feared a deflationary recession in economic activity during the fiscal year 1948. The majority of the Ways and Means Committee said:

> The added spendable income in the hands of the consumer, and incentives for business expansion which this bill provides not only are important from a long-run point of view but also as counter-actives if the recession, so frequently forecast by businessmen and Government officials, should occur in the latter part of 1947 or early 1948. If such a recession should take place, it is important that the tax reductions be made now, since a considerable period must elapse before these tax-reduction measures achieve their full economic effects.
>
> The presence of inflationary factors at the present time, due to temporary shortages of materials and manpower, will not be aggravated by the tax reduction in your committee's bill. This is true because the full effect of the tax reduction on investments and consumer spending will not be felt until some time in 1948, when it appears likely that all but a few of the shortage problems will have disappeared.[16]

The Senate Finance Committee report was somewhat more cautious in language, but it concluded, "In any case a tax reduction will be a hedge against recession and cumulative deflation, and should be enacted now." [17]

The Secretary of the Treasury argued that a tax reduction was not needed to assure a high level of economic activity throughout 1947. He said that a tax reduction would add to inflationary pressures, but he did not greatly stress this point. The President in his veto message attacked H. R. 1 on the grounds

[15] *Ibid.*, p. A4.

[16] House Ways and Means Committee Report, *op. cit.*, p. 11.

[17] Senate Finance Committee Report, *op. cit.*, p. 9.

that it would increase inflationary dangers. He said:

> The time for tax reduction will come when general inflationary pressures have ceased and the structure of prices is on a more stable basis than now prevails. How long it will take for this point to be reached is impossible to predict. Clearly, it has not been reached as yet. Tax reduction now would add to, rather than correct, maladjustments in the economic structure.

Developments during 1947 were in the direction of additional inflation and gave no support to the argument of those who favored tax reduction as a means of bolstering purchasing power. At the time of this writing (January, 1948), there are no indications of any immediate need for tax reduction to maintain aggregate purchasing power.

Another important issue in the debate about H. R. 1 was whether the rate reductions made by the bill provided equitable treatment of different income groups. Opponents of the bill pointed out that it would result in much larger percentage increases in income after taxes for high-income individuals than for those with lower income. Supporters of the bill countered by calling attention to the fact that: (1) persons with high incomes would still pay high effective rates of tax after the percentage reduction provided by the bill, and (2) even complete exemption of those with small incomes would not result in a large percentage increase in their income after taxes. They stressed the importance of high incomes as a source of savings and venture capital.

The issue of how tax reduction should be shared among different income groups was a fundamental one, reflecting basic social attitudes and economic philosophy, about which agreement could hardly be expected. Greater agreement, however, might have been expected on one factual question and one conceptual matter that were prominent in the debate. The factual question was how much of the wartime increase in income taxes would be wiped out by H. R. 1. The Secretary of the Treasury presented tables showing that the bill would eliminate a much larger fraction of the wartime tax increase for high incomes than for low and moderate incomes, and he mentioned this point in his prepared statements before both the House Ways and Means Committee and the Senate Finance Committee. Nevertheless, the contention was made several times in the Congressional debate that taxes had been increased most on high incomes during the war and that it was to be expected that tax reductions should be greatest in this area. This is not true, if tax increases are measured as a percentage of prewar taxes. Percentagewise, the wartime increases were greatest for small and moderate incomes. Prewar rates on large incomes were so high that they left less room for rate increases on these incomes than on small incomes.

The conceptual problem that figured in the debate related to the meaning of progression in income tax rates and of changes in progression. It was contended by supporters of an across-the-board tax cut that a uniform percentage reduction in existing taxes would maintain the existing degree of progressivity.[18] Opponents of the bill argued that such a reduction would decrease the progressivity of the tax system. Failure to agree on this point was indicative of the vagueness of understanding of the meaning of progressive taxation, despite

[18] See, for example, the statement of Roswell Magill, House Ways and Means Committee Hearings, *op. cit.*, p. 122. See also the argument of the majority of the Ways and Means Committee, Report, *op. cit.*, p. 8.

wide endorsement of the idea. It must be admitted that the concept of progression and especially of changes in progression presents some difficulties. A complete discussion of the issue cannot be undertaken here. It does seem fairly clear, however, that a flat percentage reduction in existing progressive tax rates would significantly alter the character of the distribution of the tax load. Perhaps the simplest way of showing this is to point out that such a flat percentage cut would actually be a "progressive" tax reduction, one which would amount to a much larger fraction of net income in high brackets than in low brackets. A series of such cuts would narrow the (number of percentage points) spread between top and bottom rates. Another way of looking at the matter is based on the idea that progression can be measured by the extent to which it reduces the inequality of disposable incomes (after taxes). On this basis, a flat percentage tax cut would reduce progression because it would give persons with the highest incomes the largest percentage increase in disposable income and thus increase the inequality of disposable incomes.

The effect of the debate about the distribution of tax reduction among different income groups was shown by the series of modifications of the rate structure. The original Knutson plan had called for a uniform 20 per cent reduction in existing taxes for all taxpayers. Even before hearings began, Mr. Knutson modified his proposal by decreasing the reduction allowed on large incomes. By a series of amendments of H. R. 1 the reduction for the smallest incomes was increased and the reduction for larger incomes decreased, until the four distinct brackets found in the final bill appeared.

H. R. 3950, a Second Individual Income Tax Reduction Bill

After the President's veto of H. R. 1 was sustained, it was at first assumed that further Congressional action on tax reduction would be deferred until 1948. In July, 1947, however, the Congress passed H. R. 3950 (80th Congress, 1st Session). This bill was identical with H. R. 1 for 1948 and later years, but it made no tax reduction for 1947. On July 18, 1947, the President vetoed this second bill, making essentially the same objections to it as to the earlier bill. The House voted to override this veto by a majority of 299 to 108.[19] In the Senate, however, the veto was sustained when supporters of the bill failed to muster a two-thirds majority in favor of overriding the veto.[20]

Ways and Means Committee Hearings on General Tax Revision

On May 19, 1947, the House Ways and Means Committee began hearings in connection with a general study of the Federal tax system, with a view to developing plans for comprehensive tax revisions. These public hearings continued through the remainder of the month of May and the greater part of June and July and were resumed in November. The record of these hearings fills four volumes, totalling more than 3,000 pages.[21] The Committee heard a large number of witnesses, and it accepted for the record many letters, briefs, and other statements from persons and groups not represented at the

[19] *Congressional Record*, Vol. 93, p. 9468 (July 18, 1947).

[20] The vote in the Senate was 57 in favor of overriding the veto and 36 opposed. *Ibid.*, p. 9448.

[21] *Revenue Revisions, 1947-48*, Hearings before the Committee on Ways and Means, House of Representatives, 80th Congress, 1st Session (1947).

hearings. The hearings covered such subjects as excise taxes, individual income taxes, corporation income taxes, and the treatment of cooperatives and other wholly or partially tax-exempt organizations.

The Secretary of the Treasury appeared as the first witness at these hearings. He made no specific recommendations as to the character of tax revisions or their timing. He conceded, however, that "A period of tax reduction is approaching " and recommended a study of all phases of the tax system in anticipation of legislative action. The Secretary listed twenty-one major tax subjects under study in the Treasury Department and offered to present studies on them as they were completed. The items mentioned were as follows: (1) corporate income tax rates; (2) taxation of dividends; (3) taxation of small business; (4) tax-exempt organizations; (5) elimination of tax discrimination among various forms of doing business; (6) business loss offsets; (7) treatment of depreciation for tax purposes; (8) taxation of American business abroad; (9) intercorporate tax problems, such as consolidated returns and intercorporate dividends; (10) individual income tax rates; (11) personal exemptions; (12) tax treatment of family income; (13) taxation of pensions and annuities; (14) averaging of income for tax purposes; (15) credit for earned income; (16) allowances for life insurance premiums and other savings; (17) taxation of capital gains and losses; (18) revision of excise taxes; (19) excise tax discrimination between domestic and imported goods; (20) revision of the estate and gift taxes; and (21) extension of social security coverage. In addition, the Secretary called attention to a number of technical tax matters that he believed needed study.[22]

The witnesses following the Secretary of the Treasury covered a wide range of subjects. Some presented comprehensive tax programs; others confined themselves to details of the Internal Revenue Code. As is usual, the quality of the material presented varied considerably. Some of the witnesses merely entered unsubstantiated pleas for lower taxes for themselves or their industry. Others, however, presented extensive briefs or statements including fairly elaborate statistical and factual data to support their economic arguments. Some of the latter material is of general interest as well as being pertinent to specific tax problems. Like similar material contained in previous revenue hearings, however, it is not likely to be widely used because the grains of useful information are mixed with so much chaff that considerable persistence is required to separate the components.

Treasury Tax Studies

The Treasury Department released a series of technical tax studies during the year. By the close of 1947, fourteen such studies had been made public; they related to eleven of the twenty-one major subjects of study listed by the Secretary in his May 19 testimony before the Ways and Means Committee.[23] With two exceptions, these studies made no explicit legislative recommendations. The exceptions were a study on estate and gift tax integration on which the Treasury staff collaborated with a committee of outside attorneys and a study

22 *Ibid,* Part 1, pp. 1-15.

23 Three of the studies related to the revision of the excise taxes, which was listed as a single subject in the Secretary's statement; and one of the studies related to Federal-state tax coordination, a subject not originally listed by the Secretary.

on business loss offsets which was prepared jointly by the technical staffs of the Treasury and the Joint Committee on Internal Revenue Taxation.

Most of the Treasury studies present rather elaborate analyses of the operation of existing law and of proposed changes in the law. Many of them contain useful factual material. The character of the subject matter and the style of presentation are such that the principal appeal of the studies is to the specialist. The issuance of such studies, however, offers interested legislators and members of the public a great amount of information on important tax issues. It remains to be seen what, if any, impact this will have on the legislative process.

Special Tax Study Committee

In June, 1947, the Committee on Ways and Means appointed a special tax study committee, pursuant to House Resolutions 293 and 297. The chairman of this special committee was Roswell Magill, attorney and former undersecretary of the Treasury, and the vice chairman was Governor Frank Carlson of Kansas, a former member of the Ways and Means Committee. The ten members of the committee also in cluded, among others: J. Cheever Cowdin, investment banker and capitalist active in the financing of aviation and motion picture companies; John L. Connolly of the Minnesota Mining and Manufacturing Company; John W. Hanes, investment banker and former under-secretary of the Treasury; and Matthew Woll, vice-president of the American Federation of Labor.

On November 4, 1947, the committee submitted its report, and at the same time Mr. Woll filed a minority report.[24] In describing its objectives, the chairman of the committee stated:

> Aside from those broad considerations of tax policy that are imperative in the postwar period, the Special Tax Study Committee addressed itself especially to those administrative provisions of the tax law that seem most in need of revision. This work has been largely technical in character and drew heavily upon the personal experience and knowledge of the various committee members in contact with the interpretation and application of the law.[25]

In outlining its tax philosophy, the majority of the committee stressed the danger that tax rates, especially individual income tax rates, might be so high that little incentive would be left to work and invest. The majority of the committee expressed concern that, under progressive rates, incentives " are being smothered and destroyed by a tax system which, instead of rewarding people in proportion to how much they strive and accomplish, punishes them with a graduated penalty that increases with their success." [26] The committee recommended " a reduction in individual income-tax rates for all, with due regard for the cost of living of those in the lower-income groups and for the needs of the balance of the economy," [27] but refrained from more detailed recommendations as to rates and exemptions. The committee recommended that excise taxes continue as an important source of revenue and added, "A case can certainly be made for strengthening the excise-tax structure so that, in less prosperous times than these, the Federal Government will still have adequate sources of revenue." [28]

[24] *Reports of the Special Tax Study Committee* to the Committee on Ways and Means, House of Representatives (November 4, 1947).

[25] *Ibid.*, p. 1.

[26] *Ibid.*, p. 11.

[27] *Ibid.*, p. 11.

[28] *Ibid.*, p. 8.

The report of the special committee was composed mainly of recommendations for technical revisions of the Internal Revenue Code. The committee emphasized the need for clarification and correction of many provisions of the Code, which it believed were resulting in unforeseen inequities. Recommendations were presented on thirty-one topics under the income tax and thirteen topics under the estate and gift taxes. In describing the program the chairman said, "Frequently these [revisions] are in the Treasury's own interest." [29] Inasmuch as all of the recommendations were calculated to decrease tax liabilities,[30] this view is a little hard to understand, unless, of course, the committee was concerned primarily with reducing the Treasury's administrative workload.

Matthew Woll vigorously dissented from the views of the majority both with respect to its general approach and most of its specific recommendations. He presented a detailed minority report of almost the same length as the majority report.

This is not the place for a detailed discussion of the recommendations of the committee nor of Mr. Woll's views. It should be noted, however, that adoption of some of the committee's "technical" recommendations would have rather far-reaching implications. Among these are the proposal to reduce the so-called double taxation of dividend income by allowing stockholders a tax credit equal to the amount of dividends received multiplied by the first-bracket rate of the individual income tax, income splitting between husbands and wives for tax purposes, placing the burden of proof on the Treasury to show that accumulations of undistributed corporate profits are unreasonable and hence subject to section 102 surtax, and allowing taxpayers any depreciation deduction entered in their own books (in the case of assets with a life of more than five years).

Taxation of Husbands and Wives

During 1947 the problem of Federal taxation of income of husbands and wives continued to receive attention both in the Congress and in the state legislatures. Under the Federal tax, income is taxable to its legal recipient and legal title to income is governed mainly by state laws. In community property states, husbands and wives share equally in the ownership of community income, whether from property or personal efforts. Division of income between husbands and wives may put the income in a lower surtax bracket and thereby result in a tax saving for couples whose combined taxable incomes exceed \$2,000.[31] Thus many married residents of community property states pay substantially less income taxes than similarly situated persons in other states. The Treasury several times has urged the Congress to eliminate this discrimination by taxing income to the spouse exercising management and control or by requiring husbands and wives to file joint returns, but these recommendations have never been accepted.

The so-called original community property states were eight in number. They were Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas,

29 *Ibid.*, p. 1.

30 The statement in the text is not quite accurate. The committee recommended that the Ways and Means Committee consider the possibility of enacting a strict statutory definition of "non-resident alien" in order to impose a tax on the capital gains of certain aliens now classified as nonresidents. *Ibid.*, pp. 22-23.

31 No tax saving is realized by the small number of couples with combined taxable incomes in excess of \$400,000, since the top surtax bracket now begins at \$200,000.

and Washington. In 1938, Oklahoma attempted to secure the tax advantages of community property for its residents by adoption of an elective community property system. The United States Supreme Court held, however, that an election under the State law was not to be given effect for purposes of the Federal income tax.[32] Oklahoma repealed its original law in 1945 and enacted a new non-elective community property law, which has been recognized by the Commissioner of Internal Revenue as valid for Federal tax purposes. In 1943, Oregon adopted an elective community property law similar to the original Oklahoma statute, but this law was repealed in 1945. Hawaii adopted a community property law in 1945, which has been recognized by the Commissioner.

Thus at the beginning of 1947, the community property system governed tax liabilities in nine states and one territory. The year 1947 saw a flurry of legislative activity in the field. Community property laws were discussed in many state legislatures and were adopted in four states. The new community property laws, all of which were recognized by the Commissioner, were in Nebraska, Oregon, Michigan, and Pennsylvania.[33] The Pennsylvania law, however, was invalidated by the State Supreme Court.[34]

Governors of some of the important states in which no legislative action on income splitting had been taken by the end of 1947 threatened to back adoption of community property laws in their states if Congress did not extend the privilege of income splitting for tax purposes to residents of all states. However, certain inconveniences and disadvantages in the community property system were recognized by the governors and others, and there were indications of reluctance to adopt the system in some of the wealthiest and most populous states.

The tax discrimination between residents of community property states and of common law states also received attention in Congress. A number of bills were introduced during the year to extend the privilege of income splitting to residents of the common law states.

H. R. 4790, the Revised Knutson Plan

On December 18, 1947, Representative Knutson, chairman of the Ways and Means Committee, introduced H. R. 4790 (80th Congress). This bill, with an effective date of January 1, 1948, provided: (1) an increase in income tax exemptions from $500 to $600; (2) income splitting for husbands and wives; (3) a special $600 exemption for persons over 65 years of age; (4) reductions in individual income tax rates ranging from 30 per-cent on the lowest incomes to 10 per cent on the highest; (5) estate and gift tax concessions for residents of community property states. Mr. Knutson estimated that his bill would reduce Federal revenues by $5.6 billion in a full year,[35] but the Treasury Department later estimated the reduction at $6.3 billion.[36]

Conclusions

Federal tax legislative activities in 1947 illustrate again the fiscal problems that arise in our form of government when the President and the majority of the Congress belong to

[32] *Commissioner* v. *Harmon*, 323 U.S. 44 (1944).

[33] For the approval of the Commissioner of Internal Revenue, see I. T. 3867, I. T. 3868, I. T. 3869, and I. T. 3870.

[34] *Willcox* v. *The Penn Mutual Life Insurance Co.*, 55 Atl. (2d) 521 (November 26, 1947).

[35] *New York Times*, December 19, 1947.

[36] *New York Times*, January 17, 1948.

different political parties. Such a situation is likely to result in conflict and frustration in any field, but taxation is perhaps especially likely to become a political battleground.

The experiences of 1947 also supply added evidence of the difficulties of carrying out a fiscal policy designed to reduce economic fluctuations. These difficulties arise partly out of the problem of obtaining effective leadership on fiscal matters, especially when the legislative and executive branches of the government are controlled by different parties. Another important difficulty is the reluctance of many political leaders to accept fiscal measures that are needed for economic stabilization whenever such measures conflict with a course of action favored for other reasons. In 1947, many of those who had previously expressed most apprehension about the size of the public debt showed least concern about the danger of continued inflation and the greatest willingness to reduce taxes at the expense of debt retirement.

Another obstacle to fiscal policy that was apparent in 1947 is the difficulty of forecasting government expenditures and revenues and of anticipating economic changes early enough and accurately enough to permit appropriate changes in tax rates to be made in advance of immediate needs. In retrospect it is clear that the Congressional committees justified their action on tax reduction on the basis of erroneous estimates of government expenditures and at least implicitly on the basis of erroneous forecasts of economic conditions. The executive branch planned on the basis of highly inaccurate estimates of revenues, which presumably reflected poor economic forecasts. There was also a tendency on the part of both the legislative and executive branches to gloss over inconsistencies between various parts of their economic forecasts and policy preferences.

In view of all of these difficulties, it is perhaps not surprising that the legislative budget procedure set up by the Legislative Reorganization Act of 1946 failed to operate in its first year of trial. The procedure had been visualized as a means of providing the Congress with a framework for systematic consideration of revenue and expenditure bills. Yet in a year of important fiscal decisions, such as 1947, the House and Senate were unable to agree even on a ceiling on appropriations. The experience of a single year, of course, is not enough basis for passing judgment on the future usefulness of the legislative procedures embodied in the 1946 act. It may be that the frustrations of 1947 will contribute indirectly to the acceptance and improvement of the idea of the legislative budget.

STATE TAX LEGISLATION IN 1947

WM. G. HERZEL *

STATES are moving at an accelerated pace in the direction of excise taxes to meet the demand for revenue to finance increased state services and aids. The year 1947 witnessed the adoption of a number of new taxes, mainly excises, and also the enactment of numerous increases in rates of existing taxes. Deductions and exemptions came in for considerable treatment. There was a noticeable trend toward greater simplification and other means of achieving more convenience for the taxpayer and expediting enforcement practices. There was some legislation relating to interstate tax cooperation and the avoidance of multiple taxation. Another interesting development dealt with state-local tax relations. Administrative reorganization was provided in a few states.

All states, except Kentucky, had regular or special legislative sessions in 1947, and some states had both. Legislation affecting tax policy and administration was enacted in forty-six of the states. This review is not intended to be a detailed coverage of every state tax enactment during 1947 but is intended, rather, to summarize the legislative developments relating to state tax policy and revenue administration.[1]

* The author is executive director of the Federation of Tax Administrators. He credits Ray H. Garrison, F.T.A. staff member, for major collaboration in the preparation of this article.

[1] A more detailed analysis of state tax legislation in 1947 will be available from the Federation of Tax Administrators at a later date.

New Taxes

The quest for additional revenue was met in several states by levying new excises, including sales taxes and tobacco taxes. Four states—Connecticut, Maryland, Rhode Island, and Tennessee—established retail sales taxes, while seven

STATES LEVYING SELECTED TAXES AND YEAR OF ADOPTION

Income Tax (34 States)		Sales Tax (27 States)		Tobacco Tax (38 States)	
1947	R. I.	1947	Conn.	1947	Ind.
1937	Colo.		Md.		Mich.
	Md.		R. I.		Minn.
1936	Ky.		Tenn.		Mont.
1935	Penn.	1942	La.		Neb.
1934	Iowa	1937	Ala.		Nev.
	La.		Kan.		W. Va.
1933	Ala.	1935	Ark.	1945	Idaho
	Ariz.		Colo.	1943	Fla.
	Kan.		N. D.		N. M.
	Minn.		Wyo.	1941	Ill.
	N. M.	1934	Iowa		Me.
1931	Idaho		Mo.	1939	Mass.
	Utah		Ohio		N. H.
	Vt.	1933	Ariz.		N. Y.
1929	Ark.		Cal.		R. I.
	Cal.		Ill.		Wis.
	Ga.		Ind.	1937	Vt.
	Ore.		Mich.	1936	Ky.
1923	N. H.		N. C.	1935	Conn.
	Tenn.		N. M.		Okla.
1922	S. C.		Okla.		Penn.
1921	N. C.		S. D.		Wash.
1919	N. D.		Utah	1933	Ariz.
1917	Del.		Wash.		Ohio
	Mass.	1930	Miss.	1931	Texas
	Mo.	1921	W. Va.	1930	Miss.
	Mont.			1927	Ala.
	N. Y.				Kan.
1915	Conn.			1926	La.
	Okla.			1925	N. D.
1912	Miss.				Tenn.
1911	Wis.			1924	Ark.
1843	Va.			1923	Ga.
					S. C.
					S. D.
					Utah
				1921	Iowa

states — Indiana, Michigan, Minnesota, Montana, Nebraska, Nevada, and West Virginia—enacted tobacco taxes. Not since the depression years in the early 'thirties have there been so many new enactments of major taxes. While major legislative activity centered on the sales and tobacco taxes, one state, Pennsylvania, joined Louisiana and South Carolina in the bottled soft drinks tax field.

The accompanying table shows the extent of tobacco, sales, and income taxes and the chronological development based on year of adoption. It is of interest to note that all four new sales tax states also employ the income tax. Connecticut, Rhode Island, and Tennessee tax corporate income, and Maryland taxes both corporate and personal income.

If the new taxes in 1947 are an index to trends in the future, many more states are likely to go into the general sales tax field in preference to income taxes. If this should be the case, it will reverse a past trend, during which six states—Georgia, Idaho, Kentucky, New Jersey, New York, and Pennsylvania—abandoned their sales taxes after brief use. In this connection, it is significant that Louisiana repealed its sales tax in 1940 but re-enacted it in 1942, and Maryland let its 1935 tax expire in 1936 only to re-establish another eleven years later. Only South Dakota and West Virginia have abandoned their income taxes, the former in 1943 and the latter in 1942.

Sales taxes.—The Connecticut sales and use tax became effective July 1, 1947, and is scheduled to expire June 30, 1951. The retailer is taxed at 3 per cent of gross receipts from sales of tangible personalty, and a complementary use tax at the same rate applies to goods brought into the State. The rate schedule on small sales is as follows: 13 to 35 cents, tax of 1 cent; 36 to 70 cents, tax of 2 cents; and 71 cents to $1.12, tax of 3 cents. The principal exempt sales include: food for consumption "off the premises," except candy; children's clothing; prescription medicines; newspapers and magazines; cigarettes and gasoline; utility services; feeds, plants, and fertilizers; sales to the State, its subdivisions, and the Federal Government, and to charitable and religious institutions. The State Tax Commission is charged with administration. Returns may be filed (a) by reporting gross receipts, including tax collected, discounting this amount 3 per cent and paying tax on the balance, or (b) by reporting gross sales exclusive of tax and paying at the rate of 3 per cent.

The Maryland enactment provided for a 2 per cent general sales and use tax effective July 1, 1947, to apply to sales of tangible personalty and selected services including hotel room rents, fabrication and printing on special orders, and building materials for resale as real estate. The bracketed rates on small purchases are: 14 to 50 cents, 1 cent tax; 51 cents to $1, 2 cents tax; and 1 cent on each 50 cents or fraction in excess of $1. Exemptions under the Maryland levy, in the main, are similar to those of Connecticut; however, they also include motor vehicles, transportation, advertising, amusements taxed by the State, and sales of less than 14 cents. Administration of the Maryland tax is handled by the State Comptroller. The statute specifically states that the retailers may not absorb the tax. They

may, however, retain 3 per cent of collections as compensation.

The Rhode Island law, effective July 1, 1947, provides for a tax of 1 per cent upon the retail sale, storage, use or consumption of tangible personal property. The tax does not apply to sales under 25 cents and is 1 cent on sales ranging from 25 cents to $1.39, and 1 cent for each additional $1.00 of purchase or fraction thereof. The retailer must add the tax to the purchase price. Exemptions are less extensive than in Connecticut or Maryland. Food sales are taxable, as are utility services, which accounts primarily for the comparatively low rate of tax. Students of sales taxes generally agree that the fewer the exemptions the simpler is the administration.

The Tennessee experiment with a 2 per cent general sales and use tax began June 1, 1947. The tax is based on retailers' gross receipts. The Tax Commissioner is given discretionary authority to determine the minimum transaction to be taxed. Exemptions under the Tennessee sales tax are essentially similar to those of Connecticut, but all food sales, except school lunches, are taxable.

Cigarette taxes.—The other major excise field cultivated in 1947 was the cigarette tax. Reference again to the table shows more enactments in 1947 than in any other year. Only ten states remain without a tax on cigarettes, and that number is likely to be cut after 1948 legislation. Rates of the new taxes vary, with 1 cent a pack of twenty in West Virginia, 2 cents in Montana and Nevada, and 3 cents in Indiana, Michigan, Minnesota, and Nebraska.

There are considerable variations in the discounts allowed wholesalers as compensation for affixing stamps or applying meter impressions. Discounts range from 5 to 10 per cent of stamps purchased. Only in Nevada is administration on a local basis. There the law provides for county sheriffs to sell the stamps, turning over the collections to the county treasurers for remittance to the State Tax Commission. It is of interest that Michigan is administering its new law without the use of stamps. Of the thirty-eight taxing states, only Massachusetts and Michigan do not use stamps or meter impressions.

Other new taxes.—New severance taxes were enacted in Indiana, Oklahoma, and Oregon. The Indiana tax applies only to oil production, and is imposed at the rate of 1 per cent of the value of petroleum severed. The tax in Oregon is limited to forest products. A new severance tax applying to natural gas and casinghead gas was enacted in Oklahoma. This excise is at the rate of 1/100 of 1 cent on 1,000 cubic feet. Both natural and casinghead gas is also subject to a production tax of 5 per cent of gross value.

A special tax on wholesalers and retailers of liquor was enacted in South Carolina. The tax on wholesalers is graduated according to annual gross profits (maximum legal mark-up) as follows: from $25,000 to $35,000, tax of 15 per cent; $35,000 to $45,000, tax of 30 per cent; and over $45,000 tax of 40 per cent. This tax must be absorbed by the wholesaler. The tax on the retailers also is graduated according to annual gross profits as follows: from $5,000 to $10,000, tax of 25 per

cent; $10,000 to $15,000, tax of 40 per cent; and over $15,000, tax of 50 per cent. Likewise, the tax on the retailer may not be shifted to the consumer.

Pennsylvania adopted a bottled soft drink sales tax to join Louisiana and South Carolina which had entered this new field several years earlier. The rate is 1 cent per 12 ounces. In view of the revenue potential and ease of administration through bottlers, it is surprising that so few states have adopted this type of tax.

Although not a new tax, a new feature, i.e., a tax on corporate net income, was added in Rhode Island to the business corporation tax formerly levied on the corporate excess. The tax on net income is not additional to the tax on corporate excess, which is retained, but the corporation pays only whichever tax yields the greater amount to the State. The rate will be 4 per cent on the net income reported to the Federal Government for 1947 and 1948, and 3 per cent thereafter. Public service corporations and banks are exempted from this tax.

Tax Rate Changes

Many states increased the rates of existing taxes instead of levying new taxes in order to balance expanded budgets. However, several states reversed the trend by reducing their income tax rates and by increasing exemptions and deductions. The rate changes included here do not cover all legislation, but they illustrate the general trend. Numerous license increases are excluded altogether. Most increases were in the selective excises.

Excises.—Seven states raised cigarette tax rates. The increase was from 2 cents to 3 cents a pack in Idaho, Kansas, New Mexico, New York, and Rhode Island; while Maine jumped from 2 to 4 cents; and Arkansas raised its rate from 5 to 6 cents, which is the highest of all state cigarette taxes.

The trend in motor fuel tax rate legislation was similar to that of cigarette taxes. Eight states—California, Colorado, Connecticut, Maine, Maryland, Nevada, Rhode Island, and Vermont—added amounts from 1 cent to 2 cents per gallon to old rates. Florida, Louisiana, and Tennessee continue to levy the highest state tax, 7 cents per gallon. In some states the rate increases were temporary, but some rates that had previously been temporary were made permanent. The increase in Nevada was levied for the benefit of county and city road improvements, and the act provides that the county commissioners in any county may refuse to accept the added tax of 1.5 cents per gallon. Of the seventeen counties, five have accepted and twelve have refused. This differential may complicate effective administration.

Alcoholic beverage taxes were significantly increased. In many states the consumer taxes were doubled, particularly on beer and wine, though some doubling occurred on distilled spirits. Nine states—Idaho, Iowa, Kansas, Massachusetts, North Carolina, Pennsylvania, South Carolina, Tennessee, and West Virginia—increased the tax on malt beverages. The increases ranged from $1.00 per barrel in Massachusetts to $4.65 per barrel in South Carolina. Seven states — Arkansas, Minnesota, New York, Rhode Island, South Carolina, Tennessee, and Wisconsin—increased their tax on wine in amounts ranging from 10 cents in Arkansas to 60 cents per gallon in Minnesota. In

the case of distilled spirits, seven licensing states — Arkansas, Massachusetts, Minnesota, Nevada, New Jersey, Tennessee, and Wisconsin—added taxes, and two monopoly states—Idaho and Vermont—made increases. The amounts ranged from 5 cents per gallon in Massachusetts to $1.50 per gallon in Minnesota. The Idaho increase was one-half of 1 per cent of the purchase price. and in Vermont the store tax was raised 10 cents per pint.

Income. — Some states made rate changes in income taxes affecting both corporations and individuals. Corporation rate increases were from 4 to 5 per cent in Colorado; 2 to 3 per cent in Connecticut; 4.52 to 6.125 per cent in Massachusetts; and 1.5 to 4 per cent in Maryland. In Oklahoma, however, the rate was reduced from 6 to 4 per cent.

Oklahoma readjusted its individual tax rates downward so that the maximum will be 6 per cent instead of 9 per cent. Iowa passed an act providing for a flat 50 per cent cut in the income taxes paid in 1947 on 1946 income. The personal income tax in New York was increased by 10 per cent of existing rates for the purpose of meeting in part the veterans' bonus payments. In Oregon, the tax rate for personal incomes over $8,000 was increased from 7 to 8 per cent.

Exemptions and Deductions

Several states provided increased exemptions, deductions, refunds, and allowances for tax collection. Income tax personal exemptions were lowered in Colorado, Oregon, and Vermont, but increased in Arkansas, Iowa, and Oklahoma.

Colorado adopted a unit exemption system patterned after that used by the Federal Government. The taxpayer, his spouse, and each dependent was granted $750. Formerly, the exemptions were $1,000 for a single person, $2,500 for a married couple or head of family, and $400 for each dependent. The unit system also was adopted in Vermont, and the exemption was made to correspond in amount to that granted by the Federal Government except that persons over sixty-five years of age will receive an additional exemption.

The personal exemptions in Oregon for single persons were lowered from $750 to $500, and for married couples from $1,500 to $1,000. The increases in personal exemptions in Arkansas were as follows: single individuals, from $1,500 to $2,500; married persons or heads of families, from $2,500 to $3,500. The exemption for a dependent was continued at $400. In Oklahoma the boosts in personnel exemptions were as follows: single individuals, from $850 to $1,000; married persons and heads of families, from $1,700 to $2,000; dependents, from $300 to $500. In Iowa, where personal exemptions take the form of a tax credit, the exemptions were raised 50 per cent. The changes were as follows: single persons, $10 to $15; married couples or heads of families, $20 to $30; dependents, $5 to $7.50.

A ceiling of 50 per cent was put on the amount of Federal income taxes deductible in computing net income for Arkansas income tax purposes.[2] Twenty-two of the thirty-four states levying either corporate or personal net income taxes at present allow deductions for Federal income taxes.

[2] The constitutionality of the reduced deduction was upheld by the Arkansas Supreme Court in *Walters Dry Goods Co.* v. *Cook*,—Ark.—; 206 S. W. (2d) 742.

Medical expenses were made deductible under the personal income tax in Missouri. However, the amount is limited, as in the Federal income tax, to 5 per cent of the taxpayer's adjusted gross income. The medical deduction in California likewise was limited to 5 per cent.

Maximum rates of depletion of mineral deposits under the Arkansas income tax were cut from 25 to 15 per cent of gross income from the property.

Several states provided additional exemptions from their sales taxes. For example, alcoholic beverages were exempted in Alabama. California excluded the amounts of city sales and use taxes from the measure of the State tax, and North Carolina exempted gasoline from the sales tax, even though a portion of the gasoline tax on the fuel may later be refunded because of nonhighway use.

Tennessee joined the ranks of those states granting refunds of tax on gasoline used for agricultural purposes. Six cents of the 7 cents per gallon tax on all gasoline used in tractors or other farm equipment used for agricultural purposes will be refunded. A sliding scale refund on aviation fuel was adopted in South Dakota. One-half of the 5 cents per gallon tax on aircraft fuel used within the State was made subject to refund. Aircraft fuel and prepared naphthas or solvents were exempted in Oklahoma. In Georgia, retailers of motor fuel or kerosene were granted a refund of 2 per cent of taxes collected to cover expenses of collecting the tax and losses in evaporation. The usual rule is to grant the distributor, rather than the retailer, compensation for collection and losses.

The discount allowed tobacco distributors for affixing the tax stamps was increased in Oklahoma, but reduced in Idaho, Maine, Pennsylvania, and Rhode Island. The increase in Oklahoma was from 3 per cent to 4 per cent on purchases of $100 or more of tax stamps. The reductions in discount rates were as follows: 7 to 5 per cent in Idaho; 7 to 3.5 per cent in Maine; 7.5 to 4 per cent in Pennsylvania; and 6 to 5 per cent in Rhode Island. Although the percentage discount rate was reduced in these four states, the distributor will in each instance receive equal or greater compensation in cents per standard case of 10,000 cigarettes than before the discount rate was cut because of increases in the rate of cigarette tax.

Simplification

There has been considerable progress in recent years toward simplification of tax laws, and compliance has been made easier for the taxpayer. The small income taxpayer has been given the privilege of filing a short return form, patterned after that used by the Federal Government. This makes for convenience to the taxpayer as well as more expeditious processing and handling of returns by the tax administrator. Six states—Colorado, Missouri, New York, Oklahoma, Vermont,[2a] and Wisconsin—adopted this innovation last year. California, Kentucky, Maryland, and Oregon already were using this practice, Kentucky having adopted it in 1946.

The short form return, based on an optional table, is usually limited to individual taxpayers having a gross income of $5,000 or less. Missouri, however, extended the privilege to individuals with incomes up to $10,000, but Wisconsin restricted the use of the optional

[2a] Vermont adopted substantially the same definition of taxable income as is used in the Federal tax. See J. K. Lasser, "State Income Tax Simplification in Vermont," pp. 62-66. [Editor]

form to those with gross receipts not in excess of $3,500.

As a rule, the optional tax table, which the taxpayer may elect to use instead of computing net income and then applying a fixed rate, is arranged to allow a fixed percentage of gross or adjusted income in lieu of all deductions. Most of the optional tables allow a standard deduction of approximately 10 per cent of gross income. Missouri, however, allows only 5 per cent, while Wisconsin grants approximately 9 per cent. Taxpayers in New York were given an optional standard deduction of the lower of 10 per cent of gross income, or $500. Oregon, which formerly allowed $350, reduced the standard deduction to $250. If a taxpayer's actual deductions exceed the optional standard deduction he may file the long return form and list all deductions.

Approximately 250,000 small taxpayers in Iowa were completely relieved of filing a State income tax return. This was accomplished by raising the amount of gross income which individuals may earn without being required to report. Only single persons having net incomes of $1,250 or more and married couples having aggregate incomes of $2,000 will be required to file.

Fewer information returns from persons disbursing income subject to the Arkansas income tax will be required. Only if the recipient obtained $2,500 or more during the year will the employer be required to file. Formerly, employers and others disbursing taxable income were required to file reports on all persons receiving $1,000 or more.

In New Jersey, corporations with a small amount of assets were given the privilege of filing their corporation franchise tax returns under a short optional rate table. Only corporations having a total assets, less reasonable reserves for depreciation, amounting to less than $100,000 may use the short rate table. Approximately 25,000 corporations will be affected.

Further simplification in income tax reporting has been made through elimination of the requirement that returns be filed under oath. Three states—Arkansas, North Dakota, and New Hampshire—removed the oath requirement last year. In 1946 Mississippi had substituted a written declaration for the oath. North Dakota still requires a written declaration that the return is made under penalty of perjury.

Sales tax tokens, usually a nuisance to purchasers, were banned in Alabama and a bracket system was substituted. Retirement of tokens in Alabama leaves only six states now using them. None of the new sales tax states has adopted either tokens or prepaid receipts.

Missouri shifted from monthly to quarterly sales tax reporting, thereby saving taxpayers and the sales tax administrator a number of mailing, posting, filing, and other clerical operations. Quarterly returns, however, may not permit as close checking on transient and seasonal business operations and may make it less difficult for a taxpayer to become substantially delinquent in his tax obligations. Of the four states adopting new sales taxes, only Connecticut provided for quarterly returns, while Maryland, Rhode Island, and Tennessee required monthly returns. Missouri is the seventh state to adopt quarterly sales tax returns.

The trend toward easing the technical procedure for obtaining refunds

of tax on motor fuel used for non-highway purposes continued. The requirement that claims be filed under oath was removed last year in California and North Dakota. In each state a declaration that the claim is filed under penalty of perjury was substituted for the oath requirement so as to protect the state against fraudulent claims. In recent years there has been a definite tendency toward extending the period during which claimants may make applications for refund. For example, last year, claimants in Wisconsin were given six months in which to file applications. Formerly, claims had to be filed within ninety days after the motor fuel was purchased. Since 1937, nine of the thirty-eight states granting refunds of tax paid on gasoline consumed either for general or specified non-highway uses have changed their filing periods to allow taxpayers more time in which to present their claims. No state has reduced the period of time in which claims must be filed. Less than a quarter of the refund states now require claims to be filed within less than four months after motor fuel is purchased.

Tightening of Enforcement

Coupled with the tendency to make compliance easier for the taxpayer, there has been a significant drive to plug loopholes against evaders. To permit taxation of out-of-state sales of property which later comes into the taxing state, a substantial majority of the states levying either general or selective sales taxes resort to the use tax device. Each of the four states enacting sales taxes last year adopted a complementary use tax. Twenty-one of the twenty-seven states taxing retail sales have provisions for taxing the use, storage, or consumption of products within the state.

Similarly, of the seven states adopting new cigarette taxes last year, five—Indiana, Michigan, Minnesota, Montana, and West Virginia—enacted use tax provisions. Three states—Connecticut, Maine, and New Hampshire—which already had cigarette sales taxes enacted use tax provisions in order to combat the growing evasion of cigarette sales taxes through interstate parcel post traffic. In addition, the tobacco tax in New Hampshire was amended to include regulation of advertisements of tobacco products shipped by parcel post or express by out-of-state dealers. State police in Pennsylvania were given authority to search without warrant any vehicle or place of business which they suspect of containing bootleg cigarettes. Of the thirty-eight states now having cigarette sales taxes, twenty also provide for taxing their use or consumption.

Recently there has been a considerable amount of discussion about the most desirable methods of enforcing taxes on special fuels, particularly liquefied petroleum gases and Diesel fuel. At present three methods are used in collecting taxes on these fuels when used for highway purposes: (1) inclusion of special fuels in the definition of taxable motor fuel under the general gasoline statute; (2) collection from the user under a separate use fuel statute; and (3) collection from licensed distributors upon the first sale except where the distributor sells to a special license holder who assumes the obligation of reporting and paying the tax on all special fuels used on the highway. Of these practices the second is the most widely em-

ployed. It was adopted last year by Idaho, Michigan, and Pennsylvania, all of which formerly used the first method. Indiana and Oklahoma amended their use fuel laws in order to simplify administration.

State governments have been slow to adopt the collection-at-the-source principle in income taxation, except as to income paid nonresidents. Oregon, which adopted a 1 per cent withholding levy effective January 1, 1948, was the first state to develop this practice as applied to all individual income taxpayers.[3] The withholding features in Oregon will apply to all wages and salaries without any deductions for the Federal income tax, social security contributions, or industrial accident contributions. Any employer whose gross payroll for any month exceeds $50 will be required to withhold, irrespective of the amounts paid individual employees. Any withholding tax collected in excess of the regular personal income tax will be refunded.

The applicability of a state or local withholding tax presents major intergovernmental problems. The Federal Government has already announced it will not withhold from Federal employees subject to the Oregon tax. The ruling, given by the Comptroller General on January 6, 1948, rests on the ground that the Oregon law imposes a direct burden on the Federal Government in exercising its governmental functions.

Further developments in interstate and intergovernmental exchange of information were noticeable. The secrecy of returns provisions in the Arkansas income tax was amended to give the Commissioner of Revenue authority to furnish the Federal Government and other states information obtained from State income tax returns. The information may be furnished only in connection with the enforcement of taxes upon, or measured by, income. Furthermore, the jurisdiction receiving information must have secrecy requirements substantially similar to those of Arkansas. Missouri granted the Federal Government permission to inspect State income tax returns.

The State Tax Commissioner in Oregon was given permission to require a taxpayer to file a copy of a Federal revenue agent's report.

Community Property

Considerable attention has been devoted in recent months to the unique problem of Federal-state tax relations arising out of the diversity of state systems of property ownership. Four states — Michigan, Nebraska, Oregon, and Pennsylvania[4]—joined ranks with nine other states already having community property laws, with the deliberate purpose of reducing the Federal income tax liabilities of their citizens because of the advantage married couples have in being allowed to divide their community income. Several states memorialized Congress to place community and non-community property states on a uniform basis with respect to the Federal income tax, and bills are pending in Congress to clear up the problem.

[3] The constitutionality of the withholding plan was upheld by the State Supreme Court on December 18, 1947, in *Marr* v. *Fisher*,—Ore.—; 18 P. (2d) 966.

[4] The community property law in Pennsylvania was declared unconstitutional on November 26, 1947, by that Commonwealth's Supreme Court in *Willcox* v. *Penn Mutual Life Insurance Co.*,—Pa.—; 55 A. (2d) 521, on the grounds that it violated due process of law and was so "vague, indefinite, and uncertain" that it could not be enforced.

Interstate Cooperation

Numerous attempts have been made to avoid multiple taxation. Real progress has been achieved in several instances. Much remains to be done, however, particularly as to corporation income and franchise taxes.

The decision in 1944 of the United States Supreme Court in *Northwest Airlines* v. *Minnesota* (322 U.S. 292), upholding the power of the state of domicile of air carriers to tax their entire fleets while other states also continue to tax the carriers, pointed up the need for greater interstate cooperation. In order to avoid multiple taxation and insure the taxing states an equitable share of air carrier taxes, the National Association of Tax Administrators in 1946 proposed for consideration by the states a uniform statute based on a formula that had been developed jointly by several organizations. Under the uniform proposal flight equipment would be taxed according to a formula made up of three equally weighted factors: scheduled aircraft arrivals and departures; originating revenue; and originating and terminating tonnage. Real property and personalty, except flight equipment, would be allocated according to ordinary rules of situs rather than by the formula. Connecticut and Nebraska in 1947 enacted the proposed uniform statute. The Connecticut statute, however, deviates from the uniform bill in one minor respect in that originating revenue will not include that derived from express and mail.

The gross income tax in Indiana was amended to permit reciprocal agreements with other states to relieve persons living in one state and working in another state from full income taxation in both. Under the reciprocity agreements residents of other states working in Indiana will receive credit on their Indiana gross income tax return for taxes paid the resident state, while residents of Indiana working in another state may credit their income tax paid that state with that amount of gross income taxes paid in Indiana. Nonresidents were granted credits in North Dakota for income taxes paid to another state on income taxable by North Dakota, provided that the taxing state reciprocates.

Much attention has recently been focused on extra-territorial enforcement of out-of-state tax claims. Early in 1946 the St. Louis Court of Appeals in *State of Oklahoma* v.*Rodgers* (—Mo. —; 193 S.W. [2d] 919) disregarding a strong line of precedent, upheld the right of one state to bring suit for collection of its taxes in the courts of another state. Possibilities of serious interstate complications were regarded as insignificant. In an attempt to facilitate enforcement of out of state tax claims, Alabama, Oregon, and Wisconsin enacted reciprocal statutes granting sister states permission to institute in their courts an original suit for taxes due them, provided the latter extend similar privileges.

State-Local Tax Relations

One of the major developments in 1947 was the action taken by a number of legislatures to put local government, both counties and cities, on a more adequate self-financing basis. There was legislation to relieve local budgets of certain expenses; to increase the share of revenues; to make per capita contributions; to abandon certain tax sources in favor of localities; to permit local units to enter a number of new tax fields not otherwise preempted by the state; and to reorganize assessment systems and provide for reappraisal

programs. Only a few of the more significant enactments are reviewed here.

Perhaps the most comprehensive state-local fiscal program was enacted by New York. In addition to other budget stabilization devices, the local taxing powers were considerably broadened. Upstate counties were authorized to levy one or more of the following taxes: a 2 per cent retail sales tax; a tax up to 3 per cent on restaurant meals over $1; a 5 per cent tax on admissions; a $10 license tax on vending machines; a $5 use tax on passenger cars and $10 for cars and trucks over 3,500 pounds; and a license tax up to 25 per cent of the State retail alcoholic beverage license fee. If a county does not impose any of these taxes, any city over 100,000 population in the county may adopt the levy. In addition, the upstate cities of over 100,000 may exclusively levy a 5 per cent tax on hotel rooms and a gross receipts tax on business, trades and professions at the rate of one-tenth of 1 per cent. New York City was specifically empowered to levy the tax on admissions, the restaurant tax, the motor vehicle use tax, and the retail liquor license tax.

Another interesting development was Ohio's vacating the admissions tax field for use by its municipalities. Florida, Maryland, and Virginia also authorized cities to levy taxes on admissions.

The mushrooming of city sales taxes was one of the most significant local tax developments in 1947. The greatest growth took place in California. In New Jersey, eleven cities including Atlantic City, were authorized to levy a 3 per cent retail sales tax. Illinois authorized cities to levy a retailer's occupation (sales) tax, not to exceed one-half of 1 per cent, subject to local referendum. The act provided that administration will be handled by the State Department of Revenue. Local governments in Pennsylvania were given power to levy virtually any kind of tax not already employed by that Commonwealth.

A few examples of other state authorizations are as follows: Alabama permitted three counties to levy taxes on malt beverages and West Virginia municipalities were authorized to tax liquor at 2 per cent of the purchase price. Minneapolis, Minnesota, was empowered to levy an income tax and a wheelage tax. Tennessee authorized certain counties to levy motor vehicle license taxes.

Another phase of legislation bearing on state-local tax relations dealt with the property tax. Arkansas repealed the State ad valorem tax, effective December 31, 1948, bringing to twenty the number of states that have entirely left the property tax field or that impose the tax only on a selective or incidental basis.

Two revampings of property assessment systems are worthy of mention. Iowa's township assessment system was replaced by a county assessor system. Trained assessors, working under the supervision of the county auditor, will be chosen by examination held by the State Tax Commission. Nebraska enacted a measure abolishing the office of 962 precinct assessors, applying to all counties with populations over 6,500. Other important enactments were the general reassessment of real estate authorized in Indiana, an Arizona appropriation of $300,000 for a reappraisal of urban real estate, and a Colorado appropriation of $100,000 for a similar program.

Tax Reorganization and Research

The trend toward unification and streamlining of the tax administrative machinery continues. A comprehensive reorganization was provided for in Indiana. There the revenue collecting agencies are to be consolidated into a single department of revenue effective July 1, 1948. The new department will be governed by a board, consisting of the Governor, State Treasurer, and State Auditor, which will effect the reorganization and hire a Commissioner of Revenue to execute the State revenue program. In Nevada the legislature reorganized the Tax Commission and made provision for the secretary of the Commission to be the principal administrator. In Oklahoma, the Tax Commission was recreated with three members designated as chairman, vice-chairman, and secretary, whereas previously the three members held equal rank. Under the new law, the commissioners are appointed with staggered terms of six years and they may be removed only for cause.

A number of legislatures established tax study committees for the purpose of examining the tax structure and tax administration of the state, localities, or both. Such committees or commissions were created in Georgia, Indiana, New Hampshire, Pennsylvania, Tennessee, Utah, Virginia, and Washington. An interim legislative commission was provided in Minnesota to consider a revision of the State constitution, and a road study committee was created in Iowa for the purpose of making recommendations on road financing.

RESEARCH PROJECT: EFFECT OF FEDERAL TAXES ON BUSINESS

J. Keith Butters [*]

THE purpose of this note is to outline the general scope, methodology, and objectives of a research project recently undertaken by the Division of Research of the Harvard Business School on the general subject of the *Effect of Federal Taxes on Business*. The project is being financed by a grant to Harvard University of $175,000 by the Merrill Foundation for Advancement of Financial Knowledge.

Even with this generous financing, the study can, of course, hope to cover only a very limited range of the effects of taxes on business, and through business on the general level and composition of the national income. It has seemed wise to cover a series of well defined, but limited, topics with considerable care rather than to spread the investigations thinly over a broader area.

The most significant contributions of the study probably will be in the area of the *direct* effects of taxes on the decisions of business executives and on those of investors in business enterprise. These direct effects will be emphasized more than the indirect economic effects of differing tax policies on, say, aggregate levels of consumption and investment. This is not to say, however, that the project will ignore general economic analysis; on the contrary, every effort will be made to interpret and present the research findings in terms of their over-all economic and fiscal significance.

With reference to methodology, the distinctive characteristic of this project will be the heavy emphasis placed on field investigations. Extensive field inquiries will be made of business managers, tax lawyers and accountants, investment counselling and banking firms, and representatives of the Bureau of Internal Revenue. Within the limits of the time available, a large number of business situations will be examined in detail to trace through various tax effects; in general, the method of approach will be similar to that employed on a much smaller scale in an earlier Harvard Business School study on the *Effect of Federal Taxes on Growing Enterprises*. [1] With the empirical background and "feel" for the problems thereby obtained, the participants in the project hope to be able to present an analysis much more relevant to the problems of the "real world" than would otherwise be possible.

Another somewhat distinctive feature of the study will be the decentralized basis on which it is to be conducted. The project will consist of a series of separate, but related, monographs on various aspects of the over-all problem. These monographs will be followed by a final summary volume which will attempt to integrate the findings of the individual monographs. Consistent with the research policies of the Business School, the authors of each separate publication will bear sole responsibility for the views and opinions expressed therein.

As of February, 1948, tentative decisions and personnel allocations have been made for nine monographs. The listing is in order of probable publication, and the titles are purely descriptive; work has actually begun on only three of the monographs, and substantial revisions may be made as the project advances. The monographs planned are the following:

J. Keith Butters, *Influence of Taxation on Inventory Accounting and Inventory Policies;*

* The author is assistant professor of finance at the Harvard Graduate School of Business Administration.

[1] J. Keith Butters and John Lintner, *Effect of Federal Taxes on Growing Enterprises* (Harvard Business School, 1945).

E. Cary Brown, *Influence of Taxation on Depreciation Policies;*

William L. Cary, *Influence of Taxation on Capital Structure in Bankruptcy Reorganizations;*

John Lintner, Cary, and Butters, *Influence of Taxation on the Acquisition of One Company by Another* (This monograph will emphasize particularly the tax incentives causing small, closely held companies to sell out to their large competitors.);

Lynn L. Bollinger, *Influence of Taxation on the Investment Capabilities and Policies of Individuals;*

Dan T. Smith, *Influence of Taxation on Corporate Financial Policy* (including the effects of taxes on capital structure, dividend policy, reorganizations, and relations with subsidiaries. Certain aspects of this volume will be closely related to the legal work to be done by Professor Cary.);

(Authors undecided), *Influence of Taxation on Management Incentives and Executive Compensation;*

(Authors not finally decided),[2] *Influence of Taxation on the Retirement and Acquisition of Assets (Primarily Capital Equipment)*;

Smith and Butters, *Summary Volume.*

No definite dates have been set for publication, but it is hoped that several of the monographs will be available late in 1948 and that the summary volume will be completed by mid-1950.

It should be stressed that this list of authors includes highly qualified specialists from other faculties: Professor Cary is on the faculty of the Northwestern University Law School, and Professor Brown is the public finance specialist of the Massachusetts Institute of Technology. It is also possible that one or more additional members of other faculties will participate as authors of some portion of the study.

The study is to be conducted under the general supervision of Dr. Melvin T. Copeland, Director of Research of the Harvard Business School. Professor Dan T. Smith is director of the project, itself, and is responsible for the general planning and conduct of the work and for the selection of personnel and monograph subjects. Professor Butters is serving as associate director.

A board of advisors has agreed to consult with the authors. These men will assist in the planning of the project, will be available for consultation as the work progresses, and will review manuscripts as they are prepared. The study undoubtedly will benefit greatly from their assistance at all stages in the work. The advisors will not, however, be held responsible in any way for the results, nor will they have other than advisory powers. As of this writing, the following men have consented to serve as advisors: Professor Roy Blough, of the University of Chicago; Mr. Albert J. Browning, Vice President of the Ford Motor Company; Dean E. N. Griswold, of the Harvard Law School; and Professor Alvin H. Hansen, of the Harvard Department of Economics. It is expected that several other members will be added in the near future. In order to assure an objective treatment and comprehensive coverage of all aspects of the problems studied, an effort has been made to obtain outstanding men of different backgrounds and points of view for the advisory committee as well as for the authorship of the respective monographs.

[2] The authors of this monograph probably will be selected from among those listed for earlier monographs, depending on the progress of these earlier monographs and the other commitments of the participating authors.

NTA NOTES

THE NEW JOURNAL: MESSAGE OF PRESIDENT MITCHELL

PROOF that even the National Tax Association is vulnerable to the trend of the times is apparent in the " new look " which accompanies the transformation of the thirty-three year old *Bulletin of the National Tax Association* into the *National Tax Journal.*

In presenting this quarterly publication to the members of the Association, I am sure the editor, Professor Roy Blough, must have intended that the new format and typography together with the sprightly cover would do more than attract your passing attention. These are merely some of the devices by which he hopes to make it easy for you to cultivate a closer and more intimate acquaintance with the substance of our new *Journal.*

For nearly two years the Executive Committee and latterly the Committee of Fifteen have been considering means of strengthening and enlarging the Association's publication program. Major attention was given to the adequacy with which the *Bulletin* served the needs of the membership, and to its sphere of special competence in relation to the peculiar interests of other publications that now are devoted to various aspects of taxation and public finance. In marked contrast to the situation in the early years of the *Bulletin's* history, there are today several special tax services, monthly news letters, and magazines reporting the current tax news and technical developments in specialized fields of taxation. Many of these publications are clearly better equipped to perform these functions than the *Bulletin.* On the other hand, no other magazine or group can provide so natural a forum for the discussion of the broad economic and social issues of alternative tax and expenditure policies as the National Tax Association. This is our area of special competence, as well as our heritage. The diversity of interest in our membership precludes a publication exhibiting either a narrow concentration on technicalities or an over-all bias in content or point of view.

Probably few of our members are aware of the parsimonious attitude of the Association toward the *Bulletin* in years past. Printing and distribution costs had long been regarded as a practical limit to our financial obligation. For many years the services of the editor, the contributions of the authors, and the clerical and stenographic expense in the editor's office were all donated. That we had a *Bulletin* to transform into a *Journal* we owe to the sustained interest and splendid work of our previous editors: James W. Martin, 1946-47; Henry F. Long, 1935-46; Carl Shoup, 1930-35; Alfred E. Holcomb, 1929-30, 1923-26, 1918-21; M. H. Hunter, 1926-29; H. L. Lutz, 1921-23; Fred R. Fairchild, 1916-18; and Thomas S. Adams, 1915-16.

The recent increase in dues makes it possible for the Association to defray a larger part of the costs of the *Journal.* We can now fairly compensate all stenographic and clerical help and furnish contributors with a liberal supply of reprints of their articles. The editorial costs are still largely contributed, but the burden on the editor has been materially lessened by the appointment of an associate editor, Professor Richard Goode, and the assistance of an Editorial Advisory Board. The members of the Editorial Advisory Board who have thus far accepted membership and their terms of service are as follows: terms expiring 1949—Leo Mattersdorf, Mattersdorf and Allen, New York, New York; H. Clyde Reeves, Commissioner of Revenue, Frankfort, Kentucky; terms expiring 1950—Roy Blakey, University of

Minnesota, Minneapolis, Minnesota; Welles Gray, Pennsylvania Economy League, Harrisburg, Pennsylvania; term expiring 1951—Arthur H. Kent, Attorney, San Francisco, California; I. M. Labovitz, United States Bureau of the Budget, Washington, D. C. The officers of the Association are ex officio members of the Editorial Board.

In the *National Tax Journal* the Executive Committee has attempted to provide a suitable medium for competent comment on important issues in public finance and taxation. We hope you will like the result well enough to be a consistent reader and frequent contributor.

George W. Mitchell, *President*,
National Tax Association

1948 NATIONAL TAX CONFERENCE

The 1948 National Tax Conference will be held October 4 to October 7, inclusive, in Denver, Colorado. The headquarters of the Conference will be in the Cosmopolitan Hotel.

Reservations for the Conference should be made with Clarence N. Hockom, manager of the Denver Convention and Visitors Bureau, Inc., 519 Seventeenth St., Denver 2, Colorado. Hotel rates are listed below. The Brown Palace Hotel is across the street from the Cosmopolitan and the Shirley Savoy is a short block away.

Plans for the program are being formulated by the Program Committee under the chairmanship of I. M. Labovitz, Bureau of the Budget, Executive Office of the President, Washington 25, D. C. Other members of the committee include: C. Emory Glander, Tax Commission, State of Ohio; Elton K. McQuery, Executive Secretary, Colorado Resources and Development Council; Harvey Willson, Manager of Revenue, City and County of Denver; Fred Bennion, Executive Secretary, Colorado Public Expenditure Council; and Paul E. Shorb, Attorney, Washington, D. C. Suggestions for topics and speakers may be addressed to the chairman or any of the members of the committee.

Hotel Rates per Day for 1948 National Tax Conference

Accommodations	Cosmopolitan	Brown Palace	Shirley Savoy
Single room	$4.50-$5.00	$4.50-$8.00	$2.75-$3.85
Double room	7.50- 8.00	6.50- 9.00	2.75- 3.85
Twin bed room	7.50- 8.00	7.00-11.00	4.00- 6.00
Suites:			
two room	15.00	20.00-28.00	
three room	25.00	30.00-42.00	

MEMBERSHIPS AND DUES

EFFECTIVE July 1, 1948, three classes of membership in the National Tax Association will be available. They are: junior membership for individuals under thirty-five years of age; senior memberships for individuals thirty-five years of age and over, libraries, corporations, governmental agencies, etc.; and sustaining memberships for any who wish to contribute to the work of the Association more substantially than members of other classes. All members enjoy the same rights and privileges.

Annual dues, payment of which entitles one to the current volume of the *Proceedings* and the *National Tax Journal*, may be paid at the first of any quarter for the ensuing twelve-month period. The dues for the three classes of membership described above are: junior memberships, $5; senior memberships, $10; sustaining memberships, $100.

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